



MISSOURI TAX CREDIT REVIEW COMMISSION

REPORT OF THE MISSOURI TAX CREDIT REVIEW COMMISSION

November 30, 2010

Co-Chairmen Chuck Gross and Steven Stogel

Senator Matt Bartle
Senator Jolie Justus
Senator Robin Wright-Jones
Representative Tim Flook
Representative Sam Komo
Jim Anderson
Zack Boyers
Mark Gardner
Luana Gifford
Bill Hall
Dee Joyner
David Kendrick
Pete Levi

Alan Marble
Troy Nash
Melissa Randol
Tom Reeves
Penney Rector
Russ Still
Craig Van Matre
Ray Wagner
Todd Weaver
Shannon Weber
Mike Wood
David Zimmerman

TABLE OF CONTENTS

	<u>Page</u>
BACKGROUND	3
GLOBAL ISSUES	10
AGRICULTURE AND ENVIRONMENT TAX CREDITS	14
BANKING AND INSURANCE TAX CREDITS	17
DISTRESSED COMMUNITIES TAX CREDITS	22
ECONOMIC DEVELOPMENT TAX CREDITS	25
HISTORIC PRESERVATION TAX CREDIT	33
LOW INCOME HOUSING TAX CREDITS	37
PROPERTY TAX CREDIT	42
SOCIAL AND CONTRIBUTION TAX CREDITS	45
TAX LAW CHANGES	48
GLOSSARY	51

BACKGROUND

Tax credits are a form of State incentive provided to businesses and individuals for their performance of a specified activity. The General Assembly adopted Missouri's first tax credit, the Senior Citizen's Property Tax Credit ("PTC"), in 1973 and, over the following decades, adopted dozens more tax credit programs to subsidize an increasing array of activities. As of today, there are 61 active tax credit programs in Missouri.¹

According to Missouri Senate Appropriations, from Fiscal Year 1998 to 2010, tax credit redemptions have grown from \$102.7 million to \$521.5 million, representing a growth rate of 407.9 % over the entire period and an average annual growth rate of 17.4 %. During that same period, net general revenue collections have increased from \$5,948 million to \$6,774 million, which represents a growth rate of 13.9 %. Tax credit redemptions have increased as a percentage of net general revenue from 1.7 % in Fiscal Year 1998 to 7.7 % in Fiscal Year 2010.

The following chart prepared by Senate Appropriations staff illustrates the growth of tax credit redemptions for all of Missouri's tax credit programs in comparison to the State's net general revenue collections:

	Tax Credit Redemption	% Growth	\$\$ Growth	Net GR Collections	% Growth	\$\$ Growth	Ratio Tax Credits to Net GR
FY98	\$102.7			\$5,947.6			1.7%
FY99	\$170.0	65.6%	\$67.3	\$6,128.3	3.0%	\$180.7	2.8%
FY00	\$314.5	85.0%	\$144.5	\$6,133.6	0.1%	\$5.3	5.1%
FY01	\$398.7	26.8%	\$84.2	\$6,388.9	4.2%	\$255.3	6.2%
FY02	\$365.2	(8.4%)	(\$33.5)	\$6,210.9	(2.8%)	(\$178.0)	5.9%
FY03	\$356.0	(2.5%)	(\$9.3)	\$5,926.3	(4.6%)	(\$284.6)	6.0%
FY04	\$408.3	14.7%	\$52.3	\$6,345.8	7.1%	\$419.5	6.4%
FY05	\$414.9	1.6%	\$6.6	\$6,711.4	5.8%	\$365.6	6.2%
FY06	\$417.4	0.6%	\$2.5	\$7,332.2	9.2%	\$620.8	5.7%
FY07	\$484.5	16.1%	\$67.1	\$7,716.4	5.2%	\$384.2	6.3%
FY08	\$504.8	4.2%	\$20.3	\$8,003.9	3.7%	\$287.5	6.3%
FY09	\$584.7	15.8%	\$79.9	\$7,450.8	(6.9%)	(\$553.1)	7.8%
FY10	\$521.5	(10.8%)	(\$63.2)	\$6,774.3	(9.1%)	(\$676.5)	7.7%
Average Annual Growth FY99-FY10		17.4%	\$34.9		1.2%	\$68.9	
Total FY98-FY10	\$418.9	407.9%	\$418.9	\$826.7	13.9%	\$826.7	

¹ A glossary of commonly-used tax credit terms is attached to this Report.

The State's twelve largest tax credit programs in 2010 authorizations include: the Senior Citizen's Property Tax ² (\$118,594,589); Low Income Housing (\$106,745,670); Historic Preservation (\$99,510,174); Missouri Quality Jobs (\$57,057,508); New Markets (\$48,750,001); Brownfield Remediation (\$21,710,015); Distressed Area Land Assemblage (\$20,000,000); Enhanced Enterprise Zone (\$17,361,344); New Generation Cooperative (\$14,483,644); Neighborhood Assistance (\$12,053,930); BUILD (\$10,476,450); and Neighborhood Preservation (\$10,290,560). Authorizations for the twelve largest programs totaled \$537,033,885 out of a grand total for all tax credit authorizations of \$588,844,114.

The State's twelve largest tax credit programs in 2010 redemptions include: the Low Income Housing (\$142,141,457); Senior Citizen's Property Tax (\$118,594,589); the Historic Preservation (\$108,064,200); Brownfield Remediation (\$17,590,273); Missouri Quality Jobs (\$14,238,179); MDFB Infrastructure (\$13,970,215); Affordable Housing Program (\$11,647,955); Neighborhood Assistance (\$10,065,992); BUILD (\$8,306,412); Health Insurance Pool (\$7,896,391); Neighborhood Preservation (\$6,739,122); Distressed Area Land Assemblage (\$6,731,634). Redemptions for the twelve largest programs totaled \$465,986,419 out of a grand total of \$522,052,722 in redemptions for 2010.

The Missouri Tax Credit Review Commission

On July 21, 2010, Governor Nixon created a Tax Credit Review Commission charged with reviewing the state's tax credit programs and making recommendations for greater efficiency and enhanced return on investment. Governor Nixon named 27 business, community and legislative leaders to serve on the Commission:

- Co-Chair former Senator Chuck Gross, Director of Administration for St. Charles County
- Co-Chair Steven Stogel, President of DFC Group in St. Louis
- Senator Matt Bartle (R- Lee's Summit)
- Senator Jolie Justus (D- Kansas City)
- Senator Robin Wright-Jones (D- St. Louis)
- Representative Tim Flook (R- Liberty)
- Representative Sam Komo (D- House Springs)
- Jim Anderson, Springfield Area Chamber of Commerce, Springfield
- Zack Boyers, U.S. Bancorp Community Development Corporation, St. Louis
- Mark Gardner, Gardner Capital, Springfield
- Luana Gifford, American Federation of Teachers, Jefferson City
- Bill Hall, Hallmark, Kansas City
- Dee Joyner, Commerce Bank, St. Louis
- David Kendrick, Kansas City Building and Construction Trades Council
- Pete Levi, Polsinelli Shughart, Kansas City
- Alan Marble, President of Crowder College, Neosho

² The Senior Citizen's Property Tax Credit is actually redeemed directly on the individual's tax return and does not include a formal "authorization process." Therefore, the amount authorized is the same as the amount redeemed.

- Troy Nash, Zimmer Real Estate Services, Kansas City
- Melissa Randol, Missouri School Boards Association, Jefferson City
- Tom Reeves, Pulaski Bank, St. Louis
- Penney Rector, Missouri Association of School Administrators, Jefferson City
- Russ Still, member of the State Board of Education, Columbia
- Craig Van Matre, member of the Coordinating Board for Higher Education, Columbia
- Ray Wagner, Enterprise Rent-A-Car, St. Louis
- Todd Weaver, Legacy Building Group, St. Louis
- Shannon Weber, Carpenters' District Council of Greater St. Louis and Vicinity
- Mike Wood, Missouri State Teachers Association, Jefferson City
- David Zimmerman, Sheet Metal Workers International Association, Local 36, St. Louis

The Commission held its first meeting on September 8 in Jefferson City, with remarks by Governor Nixon and instructions to issue a report by Thanksgiving. As the Governor explained and as the Commission's work reflects, tax credits work best when they deliver on what they were intend for—putting people to work, boosting development, and building strong communities. The Governor charged the Commission to determine which tax programs were generating a good return on investment for the taxpayers of Missouri and which were not, and to provide fact-based recommendations for improvement to ensure that the State's tax credit programs are actually creating jobs, spurring economic development and building communities.

The Governor explained that the State of Missouri is looking at a budget gap for Fiscal Year 2012 that could exceed \$400 million, but, as State revenues have declined, spending on the State's tax credit programs has grown. The Governor discussed the impact the rapid growth in tax credit expenditures has on the State's ability to fund other priorities, but he also recognized the need for the State to have well-calibrated economic development tools that incentivize job creation and capital investment and generate a positive return on the State's investment.

Significantly, the Governor admonished the Commission to avoid disturbing projects that are already underway and tax credits that have already been awarded. The Commission took this direction very seriously, adopting a "do no harm" principle so that any recommended improvement would be solely on a prospective basis in order to protect settled expectations, business certainty and the State's AAA bond rating. The Governor's full remarks may be found on the Commission's website at <http://tcrc.mo.gov>.

During its initial meeting, the Commission formed a number of committees charged with performing a detailed analysis of the tax credits assigned to them and with providing specific recommendations on each assigned program. The Commission believes that the committee structure facilitated the type of detailed analysis necessary to develop recommendations for each of Missouri's tax credit programs during the relatively compressed time frame afforded for the Commission's work.

The committees, which met on numerous occasions throughout the months of September and October, include:

Global Issues Committee

Chairs: Chuck Gross, Steven Stogel

Commission Members: Mark Gardner, Zach Boyers, Troy Nash, Pete Levi, Bill Hall, Alan Marble, Tom Reeves, Senator Wright-Jones, Senator Bartle, Jim Anderson, Ray Wagner, and Luana Gifford

Credits: Brownfield Demolition, Capital Tax Credit, Certified Capital Company, Community Development Bank, Dry Fire Hydrant, Enterprise Zone, Loan Guarantee Fee, New Enterprise Creation, Research Tax Credit, Seed Capital Credit, Transportation Development

Agriculture and Environment Committee

Chair: Alan Marble

Commission Members: Dave Kendrick, Mike Wood, David Zimmerman, Representative Sam Komo, Craig Van Matre

Assigned Credits: Agricultural Product Utilization, Alternative Fuel Stations, Charcoal Producers, Family Farm Breeding Livestock Loan Program, New Generation Co-Op Incentive, Qualified Beef Tax Credit, Wine and Grape Production, Wood Energy

Banking and Insurance Committee

Chair: Tom Reeves

Commission Members: Senator Matt Bartle, Craig Van Matre, Dee Joyner, David Zimmerman

Credits: Bank Franchise, Bank TC for S Corp, Exam Fee, Health Insurance Pool, Life and Health Insurance Guaranty, Property and Casualty Insurance Guaranty, Self-Employed Health Insurance Tax Credit

Distressed Communities Committee

Chairs: Troy Nash, Senator Robin Wright-Jones

Commission Members: Luana Gifford, Russ Still, Bill Hall, Todd Weaver

Credits: Brownfield Jobs/Investment, Brownfield Remediation, Distressed Land Assemblage, Neighborhood Preservation Act, New Markets, Rebuilding Communities

Economic Development Committee

Chairs: Pete Levi, Jim Anderson

Commission Members: Senator Jolie Justus, Representative Tim Flook, Representative Sam Komo, Ray Wagner, Melissa Randol, Dave Kendrick, Alan Marble

Credits: BUILD, Business Facility, Development Tax Credit, Enhanced Enterprise Zone, Film Production, MDFB Bond Guarantee, MDFB Infrastructure Development, Quality Jobs, Rolling Stock, Small Business Incubator

Historic Preservation Committee

Chairs: Zach Boyers, Luana Gifford

Commission Members: Tom Reeves, Senator Matt Bartle, Mike Wood, Ray Wagner (and additional non-Commission members)

Credit: Historic Preservation

Low Income Housing Committee

Chair: Mark Gardner

Commission Members: Shannon Weber, Craig Van Matre, Penny Rector, Todd Weaver, Representative Tim Flook, Dee Joyner, Senator Robin Wright-Jones (and additional non-Commission members)

Credits: Affordable Housing Assistance, Low Income Housing

Property Tax Credit

Chair: Craig Van Matre

Commission Members: Dee Joyner, Alan Marble, Penny Rector, Representative Tim Flook

Credit: Senior Citizens Property Tax Credit

Social Contribution Programs Committee

Chairs: Bill Hall, Senator Jolie Justus

Commission Members: Jim Anderson, Luana Gifford, Melissa Randol, Shannon Weber

Credits: Disabled Access – Small Business, Domestic Violence Shelter, Family Development Account, Food Pantry Tax Credit, Health Care Access Fund, Homestead Preservation, Maternity Homes, Neighborhood Assistance Program, Peace Officer Surviving Spouse Tax Credit, Pregnancy Resource Center, Residential Dwelling Access, Residential Treatment Agency, Shared Care, Special Needs Adoption/Children in Crisis (CASA), Youth Opportunities

Tax Law Committee

Chair: Steve Stogel

Commission Members: Ray Wagner, Penny Rector, Russ Still

Commission and committee meetings were conducted in compliance with the Missouri Open Meetings Law, and minutes, transcripts and other supporting documents and materials have been made available to the public via the Commission's website at <http://tcrc.mo.gov>.

During meetings and public hearings, the Commission received technical assistance upon request from administering agency staff, including the Department of Economic Development, Department of Revenue, Department of Health and Senior Services, Department of Social Services, Department of Insurance, Department of Natural Resources, Department of Agriculture, the Missouri Small Business and Agriculture Development Authority (MASBDA), the Missouri Development Finance Board (MDFB), and the Missouri Housing Development Commission (MHDC). Staff of the Joint Committee on Tax Policy of the General Assembly also provided technical assistance as requested.

Throughout the month of September, the Commission held public hearings throughout the state in St. Joseph, Joplin, Cape Girardeau, St. Louis, and Columbia. During the public hearings, the Commission received more than 24 hours of public testimony regarding Missouri's tax credit programs from nearly 100 witnesses. The Commission has also received written submissions from interested members of the public. Transcripts of public testimony and written submissions are posted on the Commission's website. In addition, several of the committees included non-Commissioners in their membership and circulated draft committee reports for public comment,

although only the votes of Commission members were counted in adopting the Commission's final recommendations.

After the statewide public hearings were concluded, the Commission held its second full Commission meeting on October 8 in Columbia. During that meeting, the Commission heard updates from the various committees on their progress, discussed the time frame and process for the committees to submit their reports to the full Commission, and scheduled additional meetings of the Commission to develop and finalize recommendations. The Commission held its third meeting by conference call on October 20 for status updates on the progress of committee work and to approve the formation of a new committee to review the Senior Citizens Property Tax Credit.

Committees submitted their individual reports to the Commission the first week of November. Copies of the reports as submitted can be found on the Commission's website at <http://tcrc.mo.gov>. On November 5, the Commission met in Jefferson City to review and analyze the committee reports, develop and adopt recommendations, and request additional committee work in areas where additional information or analysis was necessary. Committees submitted supplemental reports as necessary in advance of the Commission's November 16 and 17 meetings in Jefferson City. The supplemental committee reports can also be found on the Commission's website.

On the November 9 and 10, the Global Issues Committee met to develop recommendations on global issues affecting tax credits and their interaction with the state budget. The list of global issues was developed through discussions with Commissioners and interested members of the public and fell into four primary categories—(1) Budget Savings and Certainty; (2) Public and Private Benefits; (3) Accountability; and (4) Efficiency. The Global Issues Committee submitted its report to the Commission and later presented its recommendations during the Commission's November 16 and 17 meetings. Consistent with the Governor's charge, both the Global Issues Committee and the Commission as a whole focused exclusively on Missouri's tax credit programs and did not analyze or develop recommendations on issues of revenue generation or overall tax policy.

During its November 16 and 17 meetings in Jefferson City, the Commission finalized and adopted recommendations for inclusion in its report. Additional factual support for the Commission's recommendations can be found in the transcripts, minutes, committee reports, and other supporting materials posted on the Commission's website at <http://tcrc.mo.gov>.

The Commission's recommendations are discussed in greater detail in this report. However, several of the key recommendations include:

- Recommendations to eliminate or not reauthorize 28 tax credit programs that have outlived their usefulness and do not create a justifiable benefit in relation to their cost to taxpayers;
- Recommendations to improve the efficiency of 30 tax credit programs to provide a greater return on investment for taxpayers;

- Recommendations that no tax credits be subject to an annual appropriation process, but instead that tax credit programs be subject to review by the General Assembly according to an orderly sunset schedule;
- Recommendations that where appropriate and feasible the General Assembly impose an annual cap on all programs currently lacking a statutory cap to limit the total amount of tax credits that may be authorized annually to gain additional budget certainty for the state;
- Recommendations for changes to state and federal law that will improve the efficiency and overall value of Missouri's tax credit programs to both the State and the users of the programs; and
- Recommendations to develop a voluntary buy-back or exchange of outstanding tax credits for less than their face value in order to reduce the State's overall tax credit liability, which is currently estimated in excess of \$1 billion in outstanding credits that could be redeemed in Fiscal Years 2012 to 2022.

The Commission estimates that if all of the recommendations in the Commission's report were adopted, the State could realize short and long term savings totaling as much as \$220 million in tax credit authorizations (based on average authorizations FY07-FY09), eliminate the exponential growth of tax credit authorizations, improve budget forecasting, while at the same time better-positioning the State to compete in the economy of today as well as the economy of the future.

The Commission would like to thank the following professional firms for their volunteer professional services to the Commission on discrete legal and tax issues: Bryan Cave, LLP; Husch Blackwell, LLP; Novogradac & Company LLP; and Rosenblum, Goldenhersh, Silverstein & Zaft, P.C.

This report is being submitted to Governor Nixon for his consideration and provided to members of the General Assembly for their review and analysis. Following its submission, the Commission hopes to continue its dialogue with Missouri policymakers on the recommendations for tax credit reform contained in this report.

GLOBAL ISSUES

In addition to a detailed review and analysis of each of Missouri's specific tax credit programs, the Commission analyzed various "global issues" impacting all or a significant portion of Missouri's tax credit programs and their interaction with the State's overall budget. Based on its analysis of the global issues outlined below, the Commission adopted the following recommendations applicable to many or all of Missouri's tax credit programs.

Subjecting Some or All Programs to an Annual Appropriations Process

After extensive debate on the issue of annual appropriations, the Commission recommends that tax credit programs not be subject to the annual appropriations process. The Commission believes that the sunset schedule and statutory caps recommended herein will serve to control the growth of the State's tax credit expenditures and ensure regular evaluation of program effectiveness by the General Assembly, without creating the uncertainty associated with an annual appropriations process.

Sunset Provisions

The Commission recommends that the General Assembly impose sunset provisions on any remaining tax credit programs. The Commission recommends the following sunset schedule for consideration by the General Assembly:

- **2 year sunset – Banking and Insurance Tax Credits**
 - Bank Franchise
 - Bank TC for S Corp
 - Exam Fee
 - Health Insurance Pool
 - Life and Health Insurance Guaranty
 - Property and Casualty Insurance Guaranty
- **4 year sunset – Distressed Communities, Economic Development, Agriculture and Environment Tax Credits**
 - Brownfield Remediation
 - Neighborhood Preservation Act
 - BUILD
 - Business Facility
 - Development Tax Credit
 - Enhanced Enterprise Zone
 - MDFB Bond Guarantee
 - MDFB Infrastructure
 - Missouri Quality Jobs
 - Family Farm Breeding Livestock Loan Program
 - Agricultural Product Utilization Contributor
 - New Generation Cooperative Incentive
- **6 year sunset – Historic Preservation, Low Income Housing, Social/Contribution**
 - Historic Preservation

- Low-Income Housing
- Domestic Violence Shelter
- Food Pantry
- Maternity Homes
- Neighborhood Assistance Program
- Pregnancy Resource Center
- Residential Treatment Agency
- Shared Care
- Special Needs Adoption / Children in Crisis (CIC)
- Youth Opportunities

Limitations on the Total Amount of Tax Credits Authorized Annually

The Commission recommends that where appropriate and feasible the General Assembly impose an annual cap on any tax credit program that currently lacks a statutory cap. Such an annual cap will limit the total amount of tax credits that may be authorized annually in order to achieve additional budget certainty for the State.

Monetization or “Buy-Back” of Tax Credits

The Commission recommends that the General Assembly consider implementation of the following two options for reducing outstanding tax credit liability to achieve an overall budgetary savings to the State.

Exchange of Outstanding Low-Income Housing Tax Credits

The Commission recommends that the General Assembly enact any and all legislation necessary to authorize the Missouri Housing Development Commission (MHDC) to offer to exchange a transferrable Low Income Housing tax credit certificate in lieu of an allocation already committed to an approved project. The amount of the transferrable tax credit would be some amount less than the dollar of allocation, thereby enabling the State to redeem the credit at a discount from what the credit would have been redeemed at under current law. Depending on the implementation of other recommendations detailed in this report to modify state and federal tax law, this recommendation could save the State as much as \$75 million to \$100 million.

Dutch/Reverse Auction

The Commission recommends that the General Assembly consider establishing and funding a Tax Credit Acquisition Program (“TCAP”) for the voluntary repurchase by the State of outstanding state tax credits at a discount using an electronic auction format, as outlined in the November 11 memorandum to the Commission from Bryan Cave LLP. The purpose of the TCAP would be to facilitate the voluntary exchange of outstanding tax credits for less than the credits’ face value in order to reduce the State’s overall tax credit liability, which is currently estimated to be in excess of \$1 billion in outstanding tax credits that could be redeemed.

Program Elimination/Consolidation/Reduction

In addition to the recommendations for program elimination, consolidation and reduction elsewhere in this report, the Commission recommends that the General Assembly and Revisor of Statutes take any actions necessary to repeal the tax credits assigned to the Global Issues, which have expired or otherwise outlived their usefulness, in a manner that would not impact the redemption of any credits issued but not yet redeemed under these programs.

Elimination/Modification of Carryforward or Carryback Features

To achieve greater budget certainty for the State, the Commission recommends that for tax credits being authorized on a going-forward basis, the carryback feature be eliminated for all tax credits except the Low Income Housing Tax Credit and the Historic Preservation Tax Credit. The Commission recommends that, on a prospective basis, the carryback for Historic Preservation Tax Credits be reduced from three years to one year, and that the carryback for Low Income Housing Tax Credits be reduced from three years to two years.

Also to achieve greater budget certainty for the State, the Commission recommends that, on Historic Preservation Tax Credits authorized on a going-forward basis, the carryforward be reduced from ten years to five years from the year of issuance for any credit that is transferred in accord with state law.

Return on Investment

Throughout its work and consistent with the Governor's charge, the Commission evaluated Missouri tax credit programs to determine their return on the State's investment and sought to develop recommendations that would maximize that return. In its work and in this report, the Commission recognized that "return on investment" is most commonly measured as a monetary value—the amount of money returned into the State's General Revenue Fund as a result of tax dollars that the State spends. A positive return on investment would be a return to the State greater than the amount spent by the State on the incentive.

In assessing the return on investment for Missouri's tax credit programs, the Commission utilized the REMI model and the cost-benefit values provided on the Tax Credit Analysis forms prepared by the various tax credit administering agencies ("Form 14s). As discussed in greater detail with respect to the Economic Development Tax Credits, the Commission believes that Economic Development Tax Credits should generate a positive return on investment, as measured using the REMI model. The Commission discussed whether a requirement for a positive return on investment measured using the REMI model was appropriate for social-type tax credits intended to achieve non-economic benefits or for tax credits that are designed to achieve both economic and social benefits, such as the Historic Preservation Tax Credit or the Low-Income Housing Tax Credit, but was unable to reach a consensus in this regard.

Limits on Cost per Unit or Costs per Beneficiary

The Commission received information about projects funded with state tax credits that received what was considered to be an excessive amount of subsidy when evaluated on a per square foot,

per unit or per beneficiary basis. The Commission discussed whether an upper limit should be established with respect to the amount per square foot, per unit or per beneficiary the State should spend on any particular project. The Commission recommends that the Department of Economic Development and the Missouri Housing Development Commission monitor all projects for cost reasonableness and promulgate rules to create standards and guidelines for cost-reasonableness.

Claw-backs

The Commission recommends that strict statutory clawbacks to be enforced by the State in cases of non-compliance with program requirements be included in all tax credit programs currently lacking such provisions. The Commission recommends that all applicants for state incentives be required to enter into a contract with the agency administering the tax credit specifying standards of performance, program requirements, and penalties in the event of non-compliance.

AGRICULTURE AND ENVIRONMENT TAX CREDITS

The Agriculture and Environment Tax Credits reviewed by the Commission include the following eight tax credit programs:

- **Family Farm Breeding Livestock Loan Program**, Sections 348.500 - 348.505, RSMo.
- **Wine and Grape Production Tax Credit**, Section 135.700, RSMo.
- **Qualified Beef Tax Credit**, Section 135.679, RSMo.
- **Charcoal Producers Tax Credit**, Section 135.313, RSMo.
- **Alternative Fuel Stations**, Section 135.710, RSMo.
- **Wood Energy Tax Credit**, Sections 135.300-135.311, RSMo.
- **Agricultural Product Utilization Contributor Tax Credit**, Section 348.430, RSMo.
- **New Generation Cooperative Incentive Tax Credit**, Section 348.432, RSMo.

Family Farm Breeding Livestock Program

The Family Farm Breeding Livestock Loan Program is intended to promote family farms by allowing a tax credit for lenders in lieu of the first year interest paid on breeding livestock loans made to small farmers. In Fiscal Year 2009, \$135,281 in credits was authorized, \$135,281 was issued, and \$88,137 was redeemed. The credit is not refundable, but may be carried forward by the lender for up to 3 years. The credit may be assigned.

The Commission is concerned that this credit, as designed, provides the unintended consequence of encouraging a farmer to borrow more and at higher rates than otherwise might be the case. In other words, the credit's benefit is maximized if the loan is for the full cap amount and at as high of an interest rate as the lender believes will be approved by the Missouri Agricultural and Small Business Development Authority (which administers this program). It also perhaps incentivizes the lender and farmer to "collude" by making the ostensible interest rate in the first year of the loan to be as high as possible and thereafter reduce that rate. However, the program is limited to a maximum of \$300,000 per fiscal year (Section 348.505.2).

The apparent purpose of this credit is to encourage farmers to acquire breeding livestock. It does not seem obvious or relevant to the Commission why this goal should be related to the amount borrowed by a farmer.

The Commission recommends that this credit be restructured. The Commission suggests that the credit be related to the purchase price of the breeding livestock. Based on all tax credits issued since the program started (August 2007 – present), the actual amount of tax credits issued would have been approximately 7.0% (6.99% rounded up) of the total qualifying purchase price. Thus the Commission believes it is reasonable to assume that the same cost to the state and the goals of this credit could be more easily accomplished if the farmer receives the credit, and the credit is limited to 7.0% of the total qualifying purchase price of the eligible breeding livestock, subject to the statute's existing limits, i.e., the total qualifying purchase price is the lesser of the actual purchase price of eligible livestock or \$75,000 for Beef and Dairy, \$30,000 for Sheep and Goats, and \$35,000 for Swine.

Wine and Grape Production Tax Credit

The Wine and Grape Production Tax Credit Program is intended to promote wine production and sales in Missouri. In Fiscal Year 2009, \$252,857 in credits was authorized, \$252,857 was issued, and \$153,820 was redeemed.

The Commission recommends that the Wine and Grape Production Tax Credit be terminated during the 2011 legislative session because the credit has outlived its usefulness and does not create a benefit that is justifiable in relation to its cost to the State of Missouri. Based on the average of authorizations in Fiscal Year 2007, 2008, and 2009, elimination of the Wine and Grape Production Tax Credit could result in an estimated savings to the State of \$183,495 annually.

Qualified Beef Tax Credit

The Qualified Beef Tax Credit Program is intended to promote the beef production and processing industry in Missouri. In Fiscal Year 2010, \$43,028 in credits were authorized and issued. The program has a \$3 million annual cap.

The Commission recommends that the Qualified Beef Tax Credit be modified during the 2011 legislative session to sunset on December 31, 2013 and that, prior to reauthorization, the General Assembly fully evaluate this relatively new program to determine the relationship of the credit to its goal of promoting beef production and processing in the State of Missouri.

Charcoal Producers Tax Credit

The Charcoal Producers Tax Credit Program is intended to promote the charcoal industry in Missouri by helping to offset the cost incurred by charcoal producers to purchase and install pollution control equipment. In Fiscal Year 2009, no credits were authorized or issued, although \$134,663 in tax credits issued in prior years were redeemed. No new tax credits may be authorized under this program, and any credits previously issued must be redeemed by no later than the end of 2012.

The Commission recommends that the Charcoal Producers Tax Credit not be reauthorized as it has outlived its usefulness.

Alternative Fuel Stations Tax Credit

The Alternative Fuel Stations Tax Credit Program is intended to promote the construction of certain alternative fuel infrastructure in Missouri. Enacted in 2008, tax credits have yet to be issued under this program.

The Commission recommends that if the Alternative Fuel Infrastructure Tax Credit is reauthorized during the 2011 legislative session (currently set to sunset after tax year 2012), the General Assembly should consider expanding its applicability to include electric vehicle infrastructure and should continue the annual cap of \$1 million to ensure budget predictability.

Wood Energy Tax Credit

The Wood Energy Tax Credit Program is intended to promote the use of processed wood residue and its byproducts in the production of charcoal and other wood products. In Fiscal Year 2009, \$3,741,073 in credits was authorized, \$3,741,073 was issued, and \$4,576,446 was redeemed.

The Commission recommends that the Wood Energy Tax Credit be terminated during the 2011 legislative session (rather than waiting for it to sunset in 2013) because the credit has outlived its usefulness and its costs outweigh its benefits to the State of Missouri. Based on the average of authorizations in Fiscal Years 2007, 2008, and 2009, elimination of the Wood Energy Tax Credit could result in an estimated savings to the State of \$3,442,431 annually.

Agriculture Product Utilization Contributor/ New Generation Cooperative Incentive

The Agriculture Product Utilization Contributor Tax Credit Program is intended to promote agricultural business concepts through the funding of financial or technical assistance in the form of value-added grants, loans, equity investments, or guaranteed loans. The New Generation Cooperative Incentive Tax Credit Program is intended to induce private investment in entities that process Missouri agricultural commodities and agricultural products into value added goods, benefit Missouri's agricultural products, and result in job creation. The two programs share a \$6 million annual cap, with credits issued first to satisfy all requests for New Generation Cooperative Incentive tax credits and any remaining cap space available for Agriculture Product Utilization Contributor Tax Credits. In Fiscal Years 2007, 2008, and 2009 all \$6 million of the annual cap was authorized and issued as New Generation Cooperative Incentive tax credits.

The Commission recommends that the Agricultural Product Utilization Contributor and the New Generation Cooperative Incentive Tax Credit Programs be combined into one program with an annual cap of \$6 million, with discretion to the Missouri Agriculture and Small Business Development Authority to allocate credits under the cap to projects eligible under either former program that provide the greatest return on investment to the State of Missouri, including by providing the least amount of state funding necessary to evaluate the feasibility of the project. In addition, both programs should be modified to explicitly require that they be utilized in rural areas.

BANKING AND INSURANCE TAX CREDITS

The Banking and Insurance Tax Credits reviewed by the Commission include the following seven tax credit programs:

- **Bank Franchise**, Section 148.064, RSMo.
- **Bank TC for S Corp**, Section 143.471, RSMo.
- **Exam Fee**, Section 148.400, RSMo.
- **Health Insurance Pool**, Section 376.975, RSMo.
- **Life and Health Insurance Guaranty**, Section 376.745, RSMo.
- **Property and Casualty Insurance Guaranty**, Section 375.774, RSMo.
- **Self-Employed Health Insurance Tax Credit**, Section 143.119, RSMo.

Bank Franchise Tax Credit

The Bank Franchise Tax Credit can be claimed by a bank in an amount equal to 1/60th of 1 percent of its outstanding shares and surplus employed in this state if the outstanding shares and surplus exceed \$1 million. The tax credit has the effect of equalizing the tax treatment of financial institutions and other corporations. In Fiscal Year 2009, \$2,710,300 was redeemed.

The Commission believes that the Bank Franchise Tax Credit is a feature of Missouri's overall tax structure, rather than a true "tax credit," as that term is used to describe the state's various programs designed to provide an economic incentive or achieve a social outcome. The Bank Franchise Tax Credit was created to equalize the tax burden between financial institutions and other corporations after the General Assembly altered the corporate franchise tax. Elimination or reduction of the credit would increase taxes on financial institutions above the taxes imposed on otherwise similarly situated industries. Accordingly, the Commission believes that any recommendation regarding the Bank Franchise Tax Credit would be tantamount to a recommendation to alter the overall Missouri tax structure, which is outside the purview of this Commission.

Nevertheless, the Commission recommends that the General Assembly consider evaluating the Bank Franchise Tax Credit in the context of Missouri's overall tax structure to determine whether it is the most effective mechanism to equalize the tax burden between financial institutions and other corporations.

Bank Tax Credit for S Corporation Shareholders

The Bank Tax Credit for S Corporation Shareholders provides a tax credit for shareholders of subchapter S corporations that are banks, bank holding companies, savings and loan associations, and/or credit institutions. The purpose of the credit is to ensure that shareholders in financial institutions that are S corporations are treated similarly to shareholders of any other S corporations under Missouri tax law. In Fiscal Year 2009, \$1,862,266 in tax credits was redeemed.

The Commission believes that the Bank Tax Credit for S Corporation Shareholders is a feature of Missouri's overall tax structure, rather than a true "tax credit," as that term is used to describe the State's various programs designed to provide an economic incentive or achieve a particular social outcome. The Bank Tax Credit was created to equalize a disparity in tax burden imposed on shareholders in financial institutions organized as S-corporations and shareholders in other S-corporations. Elimination or reduction of the credit would increase taxes on shareholders in financial institutions organized as S-corporations above the tax burden imposed for shareholders in S-corporations in any other industry. Accordingly, the Commission believes that any recommendation regarding the Bank Tax Credit would fundamentally alter the overall Missouri tax structure and, as a result, is outside of the purview of this Commission.

Nevertheless, the Commission recommends that the General Assembly consider evaluating the Bank Tax Credit in the context of Missouri's overall tax structure to determine whether it is the most effective mechanism to equalize the tax burden between shareholders in financial institutions organized as S-corporations and shareholders in non-financial institutions organized as S-corporations.

Missouri Examination Fee and Other Fee Tax Credit

The Missouri Examination Fee and Other Fee Tax Credit Program credit allows the total cost of an examination paid by an insurance company, any income taxes, franchise taxes, personal property taxes, valuation fees and/or registration fees paid to be taken as a tax credit against premium tax due. The credit attempts to equalize the treatment of insurance companies and other businesses entities, which can deduct the above-referenced taxes and fees as operating expenses. In Fiscal Year 2009, \$6,529,385 in tax credits was issued, and \$4,569,160 in tax credits was redeemed.

The Commission believes that the Examination Fee and Other Fee Tax Credit is a feature of Missouri's overall tax structure, rather than a true "tax credit," as that term is used to describe the state's various programs designed to provide an economic incentive or achieve a social outcome. The Exam Fee credit was created in an attempt to equalize the tax burden on insurance companies, which, unlike other businesses when calculating income tax liability, cannot deduct certain fees and taxes as operating expenses when calculating their premium tax liability. Elimination or reduction of the credit would increase taxes on insurance companies above the taxes imposed on otherwise similarly situated industries. Accordingly, the Commission believes that any recommendation regarding the Exam Fee Credit would be tantamount to a recommendation to alter the overall Missouri tax structure, which is outside the purview of this Commission.

Nevertheless, the Commission recommends that the General Assembly consider evaluating the Exam Fee Credit in the context of Missouri's overall tax structure to determine whether it is the most effective mechanism to equalize the tax burden between insurance companies and other corporations.

Missouri Health Insurance Pool Assessment Credit

The Missouri Health Insurance Pool Assessment Credit serves Missouri residents who cannot purchase insurance in the regular market. All insurers issuing health insurance in the state are members of the pool. Individuals in the pool pay a premium and the difference between premiums paid and actual costs are assessed to members of the pool. The insurers are then allowed a tax credit against their tax liability. In Fiscal Year 2009, \$3,272,763 in tax credits was issued, and \$3,182,125 was redeemed.

The Commission believes that the Missouri Health Insurance Pool Assessment Credit is a mechanism to provide health insurance to individuals who would be otherwise uninsurable, rather than a true “tax credit,” as that term is used to describe the state’s various programs designed to provide an economic incentive or achieve a social outcome. In addition, the Missouri Health Insurance Pool Assessment Credit implicates national policy issues regarding the regulation and provision of health insurance that are outside the purview of this Commission.

Nevertheless, the Commission recommends that the General Assembly consider evaluating the Health Insurance Pool Assessment Credit to determine whether it is the most effective mechanism to enable otherwise uninsurable individuals to obtain health insurance.

Missouri Life Insurance Guaranty Association Credit

Insurers issuing life and health insurance in the state are members of the Missouri Life and Health Insurance Guaranty Association. The association pays Missouri policyholders for claims against insolvent L&H companies, and then assesses all members in the state to pay claims of the insolvent insurer. Association members are allowed to take these assessments as an offset against premium tax collected by the state. No tax credits were redeemed or issued in Fiscal Year 2009.

The Commission believes that the Missouri Life and Health Insurance Guaranty Association Credit is a feature of a national framework for the protection of policyholders against insurer insolvency, rather than a true “tax credit,” as that term is used to describe the state’s various programs designed to provide an economic incentive or achieve a social outcome. Due to the interdependency among state guarantee associations, the Commission believes that any recommendation regarding the Missouri Life and Health Insurance Guaranty credit would implicate national policy issues regarding the protection of policyholders against insurer insolvency, which is outside the purview of this Commission.

Nevertheless, the Commission recommends that the General Assembly consider evaluating the Missouri Life and Health Insurance Guaranty Association Credit to determine whether it is the most effective mechanism to protect Missouri policyholders against insurer insolvency.

Missouri Property and Casualty Insurance Guaranty Association Credit

All insurers issuing property and casualty insurance in the state are members of the Missouri Property and Casualty Insurance Guaranty Association. The association pays Missouri

policyholders for claims against insolvent P&C companies, and then assesses all members in the state to pay claims of the insolvent insurer. Members are allowed to take these assessments as an offset against premium tax collected by the state. In Fiscal Year 2009, \$2,212,598 in tax credits was redeemed.

The Commission believes that the Missouri Property and Casualty Insurance Guaranty Association Credit is a feature of a national framework for the protection of policyholders against insurer insolvency, rather than a true "tax credit," as that term is used to describe the state's various programs designed to provide an economic incentive or achieve a social outcome. Due to the interdependency among state guarantee associations, the Commission believes that any recommendation regarding the Missouri Property and Casualty Insurance Guaranty Association Credit would implicate national policy issues regarding the protection of policyholders against insurer insolvency, which is outside the purview of this Commission.

Nevertheless, the Commission recommends that the General Assembly consider evaluating the Missouri Property and Casualty Insurance Guaranty Association Credit to determine whether it is the most effective mechanism to protect Missouri policyholders against insurer insolvency.

Self-Employed Health Insurance Tax Credit

The Commission recommends that the Self-Employed Health Insurance Tax be terminated because it provides its greatest incentive and benefit to those individuals who can most afford health insurance while providing the least benefit to those who cannot.

Section 143.119.1 specifies that the credit is equal to ". . . the portion of such taxpayer's federal tax liability incurred due to such taxpayer's inclusion . . . [of health insurance premiums which are non-deductible under Section 162 of the Federal Internal Revenue Code] in federal adjusted gross income." These tax credits are refundable but are not transferrable.

In 2009, this Credit resulted in redemptions of slightly less than \$1,800,000 and the projected redemption amount each year is about \$1,800,000 for the next several years. The Tax Credit has no discernable purpose other than allowing persons who are self-employed to reduce the amount of their state income tax (or even receive a refund) based on the amount they paid for health insurance. The Credit is claimed on a form "MO-SHC." The Credit grows as a taxpayer's income increases until the Credit is equal to the highest marginal federal tax rate multiplied times the amount of the health insurance dollars paid by the taxpayer. Beginning in 2011 and absent modifications to the federal tax rates by Congress, the highest marginal rate is 39.6% of federal taxable income earned in excess of \$250,000. The mechanism the Credit allows is to permit the highest marginal tax rate to be multiplied times the amount paid for health insurance to produce the Credit. Thus, instead of the first dollars earned at the lowest rate being utilized for the Credit (15% on taxable income below \$36,900 for married taxpayers filing joint returns), the highest marginal rate is permitted to be multiplied times the health insurance premiums paid.

The effect of the Credit is to give the greatest amount of dollars to those taxpayers earning the highest incomes.

If the purpose of the Credit is to allow persons who otherwise would not be able to purchase health insurance a credit so as to induce them to purchase health insurance, then the Credit as presently designed accomplishes exactly the opposite result, i.e., those persons with the lowest incomes receive the least benefit and the persons with the highest income receive the most benefits. Presumably the persons with the highest incomes would have health insurance regardless of the Credit, and the small amount of the Credit which is granted in favor of the lower earning taxpayers may not make any difference in those taxpayers deciding whether to purchase health insurance.

Thus, as indicated above, the Commission recommends that this Credit be abolished. To the extent it is replaced, it should be in the form of some type of subsidy for low-income bracket taxpayers which may be applied (or refunded) if they purchase health insurance. For example, if this tax credit were modeled on the same system utilized by the property tax "Circuit Breaker" Tax Credit authorized by., a full credit amount would be awarded for persons making less than (for example) \$14,000 per year and that Credit would phase out as income rose above that amount to a certain predetermined maximum income amount (e.g., \$30,000 in the case of the Circuit Breaker Tax Credit). Perhaps larger amounts of income would be appropriate under these circumstances because of the relative expense of health insurance (usually a substantially greater amount than real estate taxes) and the desirability of inducing persons in lower income brackets to acquire health insurance so as to avoid for Missouri the need to pay increased Medicaid costs.

For example, if the credit were applicable to all taxpayers earning less than \$50,000 of adjusted gross income in a calendar year, and the credit were 20% of the cost of health insurance premiums paid, but said credit phased out as income rose above \$30,000 (such that for each \$1,000 above \$30,000, the credit reduced 1%), a meaningful credit and inducement to lower income taxpayers to purchase health insurance would exist and a unnecessary benefit to higher income earners would thereby be eliminated.

Based on the average of redemptions in Fiscal Years 2007, 2008, and 2009, elimination of the Self-Employed Health Insurance Credit could result in an estimated savings to the State of \$1,384,366 annually.

DISTRESSED COMMUNITIES TAX CREDITS

The Distressed Communities Tax Credits reviewed by the Commission include the following six tax credit programs:

- **Brownfield Jobs/Investment**, Sections 447.700-447.718, RSMo.
- **Brownfield Remediation**, Sections 447.700- 447.718, RSMo.
- **Distressed Land Assemblage**, Section 99.1205, RSMo.
- **Neighborhood Preservation Act**, Sections 135.475-135.487, RSMo.
- **New Markets**, Section 135.680, RSMo.
- **Rebuilding Communities**, Section 135.535, RSMo.

Brownfield Jobs/Investment

The Brownfield Jobs and Investment Tax Credit provides a tax credit for a business that creates at least 2 new jobs or retains at least 25 jobs at a formerly-contaminated site that successfully participates in the Department of Natural Resources' Voluntary Cleanup Program. In Fiscal Year 2009, \$300,000 in Brownfield Jobs/Investment Tax Credits was authorized, \$1,860,534 was issued, and \$1,965,406 was redeemed.

The Commission recommends that the Brownfield Jobs/Investment Tax Credit be eliminated during 2011 legislative session and consolidated with the Enhanced Enterprise Zone Tax Credit Program. Based on the average authorizations for Fiscal Years 2007 through 2009, the Commission estimates a potential savings to the State of approximately \$100,000 annually.

Brownfield Remediation

The Brownfield Remediation Tax Credit provides an incentive to redevelop property contaminated with hazardous waste through the Department of Natural Resources' Voluntary Cleanup Program. In Fiscal Year 2009, \$10,527,923 in tax credits was authorized, \$22,121,637 in tax credits was issued, and \$29,194,784 in tax credits was redeemed.

The Commission recommends that Brownfield Remediation Tax Credit be modified during the 2011 legislative session to impose, for the first time, an annual cap on tax credit authorizations under the program equal to the average amount authorized under the program during the last three fiscal years (approximately \$25 million). Imposing a cap on this program will provide greater budget certainty and control for the State without jeopardizing the effectiveness of this extremely valuable tool for redeveloping and returning to productive use formerly-contaminated properties.

The Commission also recommends that the Brownfield Remediation Tax Credit be modified during the 2011 legislative session to improve the program to provide the following:

1. Reduce the amount of the credit available for soft costs to 25% from the current 100%, with hard costs remaining eligible for 100% credits;

2. Prohibit the stacking of multiple state incentives unless the project generates a positive fiscal impact to the state;
3. Require a positive return on investment to the state (defined as a greater than one-to-one return identified by the REMI economic model) over a period of six years; and
4. Impose a statutory clawback requiring repayment of the value of the credits in the event that estimated jobs and investment does not occur.

Distressed Area Land Assemblage

Under the Distressed Area Land Assemblage Tax Credit program, an applicant that has incurred, within an eligible project area, acquisition costs and whom has been appointed by the local municipality as redeveloper of a redevelopment area is entitled to a tax credit of fifty percent of the acquisition costs and one hundred percent of the interest costs incurred for a period of five years after the acquisition of an eligible parcel. Since the program's inception, \$20 million in tax credits have been authorized and issued.

The Commission recognizes that an existing project has applied for and has been authorized to receive tax credits under this program. Accordingly, the Commission recommends that the General Assembly make no changes to the program that would disturb the existing project's eligibility for tax credits up to the \$95 million total program cap. However, the Commission recommends that, on a prospective basis, the General Assembly prohibit the authorization of any new applications under this program to prevent it from being used for any other project.

Neighborhood Preservation

The Neighborhood Preservation Tax Credit provides an incentive for homeowners in certain lower income areas to rehabilitate their homes or an incentive for "in-fill" new construction of owner-occupied housing. In Fiscal Year 2009, \$10,378,968 in tax credits was authorized, \$5,434,477 in tax credits was issued, and \$5,176,659 in tax credits was redeemed.

The Commission recommends that the General Assembly make the following modifications to the Neighborhood Preservation Program during the 2011 legislative session:

1. Eliminate the "first-come-first-served" requirement that creates a lottery process for selecting eligible applicants in favor of a more targeted neighborhood-based approach that allows evaluation and funding of the most high impact projects that provide the best return on investment;
2. Expand eligibility to neighborhood associations and other non-profit neighborhood groups;
3. Reduce the existing annual program cap to \$12 million from the current \$16 million to more closely reflect the actual usage and to provide greater budget certainty for the state, but also allow the cap to be allocated to qualifying and eligible areas based on demand, rather than half of the cap being automatically set aside for each. Based on the average of authorizations in Fiscal Years 2007 through 2009, reduction of the cap could result in an estimated annual savings to the State of as much as \$2,126,233; and
4. Require that a resident of a property rehabilitated using the Neighborhood Preservation

Program reside in the rehabilitated home for a minimum of five years following the rehabilitation or reimburse the state in an amount equal to the pro rated share of the value of the credits.

New Markets

The state New Markets Tax Credit may be used either to attract significant amounts of capital into funds established for the purpose of providing financing to Missouri businesses located in targeted areas of the state or to close a funding gap on a specific business development deal. Under the current program, no new equity investments may be accepted after July 1, 2010, effectively ending the program. In Fiscal Year 2009, \$21,684,000 in tax credits was authorized under the program.

The Commission recommends that the state New Markets Program not be reauthorized unless and until the federal New Markets Program has also been reauthorized, and that, before reauthorization, the General Assembly require a complete report regarding the program's effectiveness, including the list of companies receiving loans, the number of jobs created, the private investments made, and the costs associated with fund management, including all fees and professional services. Finally, the Commission recommends that, if the General Assembly reauthorizes the program, it establish a pricing floor for the tax credit in order to increase the efficiency of the program and thereby obtain a greater return on investment for the state.

Rebuilding Communities

The Rebuilding Communities Tax Credit program provides a tax credit for eligible businesses locating, relocating or expanding within a distressed community. The program has an annual cap of \$8 million. In Fiscal Year 2009, \$2,002,376 in tax credits was authorized and issued, while \$1,548,622 in tax credits was redeemed. Based on the REMI model, for every dollar spent in Rebuilding Communities Tax Credits, the State receives a \$.13 in net General Revenue over a one-year period.

The Commission recommends that the General Assembly eliminate the Rebuilding Communities Program during the 2011 legislative session. The Commission believes that the purposes of the credit can be more effectively accomplished through other economic development programs. Based on the average of authorizations in Fiscal Years 2007 through 2009, elimination of the Rebuilding Communities Tax Credit could result in an estimated savings to the State of \$1,788,394 annually.

ECONOMIC DEVELOPMENT TAX CREDITS

The Economic Development Tax Credits reviewed by the Commission include the following ten programs:

- **BUILD**, Sections 100.700 - 100.850, RSMo.
- **Business Facility (Headquarters)**, Sections 135.100 to 135.150, and 135.258, RSMo.
- **Development Tax Credit**, Sections 32.100 - 32.125, RSMo.
- **Enhanced Enterprise Zone**, Sections 135.950 - 135.973, RSMo.
- **Film Tax Credit**, Section 135.750, RSMo.
- **MDFB Bond Guarantee**, Section 100.297, RSMo.
- **MDFB Infrastructure**, Section 100.286, RSMo.
- **Missouri Quality Jobs**, Sections 620.1875 - 620.1890, RSMo.
- **Incubator Tax Credit**, Section 620.495, RSMo.
- **Rolling Stock Tax Credit**, Section 137.1018.4, RSMo.

Success in economic development today and into the future requires that Missouri focus on three primary strategies: recruiting businesses to the state, incentivizing the expansion and retention of existing businesses, and fostering the growth of business startups. In today's economic development environment, Missouri must be equipped to compete with other states and countries to attract, retain and grow businesses with competitive business development incentives that are easy to understand, promote and utilize, and which complement Missouri's business-friendly environment by providing direct incentives to businesses that create jobs and make capital investments and by providing the financing necessary for the public infrastructure that facilitates business growth.

State tax credits are an important part of Missouri's business development toolkit. Changes in today's economy and the evolution of operations have highlighted areas where Missouri's business development tax credits fall short in providing the most effective means to promote business development, job creation and capital investment. To make the most effective use of Missouri's business development tax credits and the taxpayer dollars they utilize, Missouri's tool kit should contain business development tax credits that:

- Complement and effectuate the strategic objectives developed through the Governor's Strategic Planning Initiative for Economic Growth by targeting high-growth industries to attract, retain and grow in the state
- Incentivize targeted economic activity that would otherwise not occur without the tax credit;
- Give priority to measurable job growth and capital investment; and
- Bear a proportionate relationship to the industry sectors that make up our existing and emerging economic base.

When working to recruit or retain a business prospect, the State will calculate and communicate the available business development tax credits to the prospect in the form of a proposal. In the current economic development climate, a business prospect is often simultaneously considering similar such proposals from competing states (or even countries). This competitive landscape

makes it critical for Missouri to be able to present a concrete, streamlined, and easy to understand proposal that can influence business decision-making on a real-time basis.

The ability to provide a concrete proposal, with confidence of the continued existence of the incentive or finance tool, provides the certainty necessary for business decision-making to occur. Tax credits, which are authorized by statute, complement this proposal process. Subjecting Missouri's business development tax credits to an annual appropriations process could severely hamstring Missouri's ability to provide the kind of concrete proposals necessary to attract and retain businesses that will create jobs and make significant capital investment in the state. The General Assembly should establish appropriate criteria in the award of both discretionary and entitlement business development tax credits. The Commission hopes that the guiding principles related to the use of business incentives set forth below will aid the General Assembly in that process.

Guiding Principles for Economic Development Tools

- **Positive Return on Investment**
 - Discretionary business development tax credits offered directly to a business should be used only when the project is projected to provide a positive return on investment, defined as a fiscal benefit to the state General Revenue fund net of the cost of the incentive and measured by a REMI or equivalent model. The amount of this return may vary between programs.
- **Return on Investment Within a Defined Time Period**
 - The fiscal benefits to the state General Revenue fund should occur within an established time period, not to exceed 10 years, but in no event greater than the term of the benefit. However, discretionary business development tax credits used for public infrastructure should be allowed a longer period in which to gain a positive return on investment, not to exceed 20 years.
- **Focus on Primary Jobs**
 - Business development tax credits should focus predominantly on "primary" or "base" jobs, which are jobs that produce goods or services in excess of what can be consumed within the local market and thereby bring new money into the local economy.
- **Reward Higher-Paying Jobs With Benefits**
 - Business development tax credits should reward higher paying jobs (above county average wage) with due consideration for location, local employment (recent job loss), job numbers, and company permanency.
 - Business development incentives should reward companies who offer health insurance to their employees.
- **Consider Local Participation**
 - Business development tax credits should consider (and reward) cost sharing with local governments.
- **Flexibility**
 - Business development tax credits should be flexible to meet targeted, high growth industries and sectors, to incent a business activity or close a financing gap, and to

apply to a variety of eligible activities, applicants and uses (able to address industry-specific cost pressures).

- **Simplicity**
 - Business development tax credits should be simple to understand, promote and execute and should be streamlined in their operation.
- **Up-Front Financing**
 - Business development tax credits should allow for the option of up-front financing in certain circumstances through the use of refundable tax credits, with defined clawbacks for non-performance.
- **Entitlement and Discretionary Components**
 - Business development tax credits should possess both entitlement and discretionary components, to provide both the certainty offered by an entitlement credit along with the project-specific flexibility offered by a discretionary credit.
- **Broad Applicability**
 - Business development tax credits should work in both urban and rural areas of the state and should be available for large and small businesses.

Specific tax credit recommendations

Applying the above Guiding Principles, the Commission developed the following recommendations for Missouri's current economic development tax credit programs.

Program	Recommendations
BUILD (1 yr REMI 7.29)	The Commission recommends that the General Assembly lower the minimum thresholds for eligibility and participation in the BUILD Program to 250 jobs (from 500 jobs) or 150 jobs (from 250 new jobs) in Distressed Areas for Office Projects and 75 new jobs (from 100 new jobs) for Manufacturers to enable a greater number of businesses to take advantage of the program, with the recognition that any increased utilization of the program could potentially result in increased cost to the state.
Quality Jobs (1 yr REMI 3.65) (10 yr REMI 5.06)	<p>The Commission recommends that the General Assembly amend the program to include a discretionary component (an additional tax credit awarded calculated as a percentage of total new payroll) that would allow for the direction of funding to targeted industries and allow for the option of up-front financing in certain cases. This up-front financing may be accomplished through the award, by contract with the recipient, refundable tax credits in the first year, with a clawback and performance benchmarks, as opposed to providing tax credits over time based upon performance. The total annual amount of up front tax credits that may be awarded should be limited by statute to ensure budget certainty and would be reduced from the programs' existing annual cap.</p> <p>The Commission recommends that the program be amended to lower the</p>

	<p>current job thresholds to 10 jobs for a period of not more than 3 years in order to promote economic recovery and increase job growth, with the recognition that any increased utilization of the program could potentially result in increased cost to the state.</p> <p>The Commission recommends that the program be amended to include a tax credit benefit to allow for certain levels of capital investment that occurs in the state by creating a tax credit awarded based on a percentage of total new capital investment, with the recognition that any increased utilization of the program could potentially result in increased cost to the state.</p>
<p>Enhanced Enterprise Zone (1yr REMI 1.65) (10yr REMI 4.61)</p>	<p>The Commission recommends amending the program to include a discretionary option for up-front financing in certain cases. This up-front financing could be accomplished through the award, by contract with the recipient, refundable tax credits in the first year, with a clawback and performance benchmarks, as opposed to providing tax credits over time based upon performance. The total annual amount of up front tax credits that may be awarded should be limited by statute to ensure budget certainty and would be reduced from the programs' existing annual cap.</p> <p>The Commission recommends amending the program to provide a more flexible definition of distressed communities that would include extreme situations of blight and economic obsolescence, with the recognition that any increased utilization of the program could potentially result in increased cost to the state.</p>
<p>MDFB Infrastructure (1yr REMI .30)</p>	<p>The Commission recommends that the MDFB evaluate and consider administrative changes to make the program operate more efficiently and maximize return on investment consistent with the Commission's Guiding Principles for economic development tax credits.</p> <p>The Commission recommends that the value of the MDFB Infrastructure Credit be reduced from 50% to 35% of eligible contributions and that the definition of taxpayer be conformed and broadened consistent with the Commission's recommendations for the Social and Contribution Tax Credits.</p>
<p>Incubator Tax Credit (1yr REMI .67) (10yr REMI .74)</p>	<p>The Commission believes that the certified incubators that use this tax credit could be more effectively funded through a grant program based on an annual appropriation process. The current \$500,000 cap, when divided up among all of the certified incubators around the state, fails to provide sufficient efficiencies of scale to operate a contribution tax credit program. The Commission recommends that, in place of the credit, funding for a grant program could be appropriated to the Missouri Technology Corporation for award and distribution in a manner similar to</p>

	the existing process for funding Innovation Centers and other similar state and federally-funded programs. Any proposed grant program should also include a required match in order to maintain the private match currently enabled by the tax credit.
Development Tax Credit (1yr REMI .04)	The tax credit uses a cumbersome process requiring a non-profit to actually hold title to equipment purchased by a business and then lease it back to the business. The Commission recommends that the General Assembly create a more efficient design that retains the discretionary component of the credit for helping to offset equipment purchases and upgrades and is specifically targeted at the retention of Missouri businesses. Additional changes could include allowing additional benefits for higher paying jobs with health benefits, requiring proof of either a long-term lease or minimum amount of private capital investment, and rewarding companies with a significant likelihood for additional expansion. Simplifying the process would help to eliminate unnecessary transaction costs and thereby provide a greater benefit to companies for the same cost to the state.
Business Facility	The current credit is too narrow in its focus and too limited in its eligibility requirements to be broadly utilized to attract and retain jobs and capital investment. The Commission recommends the eligibility requirements be expanded to include additional targeted industries and allow greater flexibility to calibrate the amount of benefits based on the jobs created, capital investment, and overall return to the state, with the recognition that any increased utilization of the program could potentially result in increased cost to the state. The Commission also recommends that the credit be modified to allow for an incentive based on capital investment alone.
Film Tax Credit (1yr REMI .32) (10yr REMI .11)	This tax credit serves too narrow of an industry and fails to provide a positive return on investment to the state. There is currently no long-term opportunity for the location of production facilities for films in Missouri. Accordingly, the Commission recommends that the credit be eliminated during the 2011 legislative session.
Rolling Stock	The Commission recommends that this tax credit be eliminated. This tax credit serves too narrow of an industry and fails to require a positive return on investment to the state.

Angel Tax Credit

The Commission recommends the General Assembly establish a new Angel Tax Credit Program to address the financing gap that serves as an obstacle to growing new businesses in the State.

Under this program, the Department of Economic Development could authorize tax credits to encourage equity investment in technology-based early stage Missouri companies, commonly referred to as angel investments. Investors who contribute a benchmark amount in equity investment to a qualified Missouri business may be issued a tax credit equal to an established percent of the investment or a higher percent of the investment if the qualified business is located in a rural area or distressed community.

To create this new program while remaining revenue-neutral, the Commission recommends that the existing cap on the Film Tax Credit (\$4.5 million) be utilized.

Unified Economic Development Program

In addition to the tax-credit specific recommendations above, the Commission has also adopted a global recommendation for improving Missouri's toolkit by replacing various economic development tax credit programs with one flexible, unified program. This unified program could utilize the pool of funding represented by the existing program caps, while at the same time better effectuate the Guiding Principles identified by the Commission as being necessary to create jobs and promote capital investment in the state. The combined annual cap of the new unified economic development program should be a function of the total existing program caps, with due consideration of a reduction of that annual cap equal to any amounts currently obligated for each future year and reflective of the actual average maximums obligated.

Specifically, the Commission recommends that the General Assembly adopt a unified economic development credit that follows the guiding principles to replace the existing BUILD, Enhanced Enterprise Zone, Business Facility and Missouri Quality Jobs Programs. As discussed in greater detail above, these guiding principles include:

- Positive Return on Investment
- Return on Investment Within a Defined Time Period
- Focus on Primary Jobs
- Reward Higher-Paying Jobs With Benefits
- Consider Local Participation
- Flexibility
- Simplicity
- Up-Front Financing
- Entitlement and Discretionary Components
- Broad Applicability

The features of this unified credit would include:

- Provides for both a retention of withholding taxes and a refundable tax credit by an eligible company;
- Includes an entitlement base benefit similar to Quality Jobs using withholding taxes, with an additional discretionary benefit in the form of refundable tax credits, based on the amount of positive return on investment for the state, the amount of local participation, the level of competition with other states, or the existence of a proven gap financing;

- Creates an established annual statutory cap, which reflects the reduction of any obligations under current programs;
- Allows for “up front” financing to be accomplished by allowing the award of refundable tax credits to a company in the first year, with a contract, complete with clawbacks and benchmarks. A maximum annual amount of up-front refundable credits should be specified in statute to provide budget certainty, and the award of any up-front credits should be counted against the program’s overall annual cap;
- Provides an additional discretionary benefit for targeted industries identified in the Governor’s Strategic Planning Initiative for Economic Growth;
- Provides limits on “stacking” other state incentives;
- Provides the benefit based on both new jobs to the State (jobs at the facility over and above the number of jobs in Missouri working at the same company at all facilities in the 12 months previous) and capital investment made in the state;
- Creates a requirement that any discretionary tax credit awards be subject to a positive return on investment over a fixed period of time;
- Includes company eligibility criteria similar to the current Missouri Quality Jobs program (benchmark number of jobs, benchmark amount of investment, wage amounts and health insurance), but is flexible enough to be utilized by large and small businesses and in rural and urban areas;
- Creates a priority for companies with a majority of their business in interstate commerce, like in the current EEZ and BUILD programs;
- Requires a financial “but-for” requirement similar to that in the current BUILD program, whereby the project would need to demonstrate that without state assistance to fill a financing gap, the project would otherwise not occur;
- Provides that any obligations incurred by the state under existing tax credit programs would continue and would be honored for the full term of their award; and
- Focus on new economic development as well as on retention of existing jobs and investment.

Resolution Urging Congressional Action on State Incentives

Finally, the Commission believes that there currently exists a problem in interstate competition where States manipulate the marketplace with incentives and cannibalize each other's industries. The situation is the most problematic when a company is incentivized to move from one state to an adjacent state but within the same metropolitan area by the new state’s incentives for creating “new jobs” when there is no net new job creation for the overall metropolitan area. This scenario has occurred recently with a number of large companies that have moved across the state line between Missouri and Kansas, but still within the Kansas City metropolitan area, with most aided in relocating existing jobs to the new state with the new state’s economic development incentives intended for “new jobs.”

The Commission believes that as greater portions of limited tax revenues are devoted to competition between states for business recruitment, the availability of state funding for education is jeopardized, making us less competitive as a state and a nation. The Commission believes that education is our number one economic development tool. Accordingly, the Commission recommends that the General Assembly send a resolution to Congress urging action

to prevent a continued arms-race of interstate competition with taxpayer-funded economic incentives, particularly when this competition results in the use of incentives for relocating a company to another state within the same metropolitan area and thereby creating no net new economic development while at the same time eroding state budgets.

HISTORIC PRESERVATION TAX CREDIT

The Tax Credit Review Commission reviewed the Missouri Historic Preservation Tax Credit program, found at Section 253.545 *et seq.*, RSMo.

Background

The Missouri Historic Tax Credit Program was created in 1997 by the General Assembly and the program became effective January 1, 1998 for the purpose of providing an incentive for the redevelopment of commercial and residential historic structures in Missouri. DED administers the Program and is responsible for the issuance of all tax credits based upon final certification of the rehabilitation project by the Missouri Department of Natural Resources, State Historic Preservation Office (“SHPO”). In Fiscal Year 2009, \$211,950,941 was authorized, \$119,914,948 issued and \$186,426,164 redeemed. Beginning in Fiscal Year 2011, no more than \$140 million in tax credits may be authorized in any fiscal year. Renovation of historic structures positively impacts local tax collections from property, sales, and income taxes, and benefits an area from increased attractiveness, further investment and, lower crime rates related to higher-visibility/higher use areas.

The Program was designed to provide state tax credits equal to 25% of eligible costs and expenses of the rehabilitation of approved historic structures. An eligible property must be (i) listed individually on the National Register of Historic Places, or (ii) certified by the Missouri Department of Natural Resources as contributing to the historical significance of (a) a certified historic district listed on the National Register, or (b) a local historic district that has been certified by the US Department of the Interior. Eligible costs include, but are not limited to, qualified rehabilitation expenditures (“QREs”) as defined under the federal program. Generally, improvements made within the “footprint” of the building are eligible if they are permanent. Soft costs directly related to the rehabilitation, such as architect’s fees, are also allowed. To qualify for credits, however, QREs associated with the rehabilitation must exceed 50% of the total basis of the property (i.e. the acquisition cost).

The tax credits issued under the Program can be applied to state income taxes (excluding withholding taxes) under Chapter 143 and to taxes under Chapter 148, including the Bank Tax, the Insurance Premium Tax and the Other Financial Institution Tax. Any taxpayer is eligible to participate in the Program. Not-for-profit entities and government entities are ineligible. Tax credits must be used first in the year they are issued. If there is any excess, they may be carried back to any of the three (3) preceding years and carried forward for the succeeding ten (10) years. Tax credits may also be sold or transferred in accord with Missouri law.

In 2009, the General Assembly passed House Bill 191 (2009) and made significant changes to the Program in an effort to address growing concerns over the fiscal impact of the Program on the state budget. These changes imposed new annual limits on the amount of tax credits approved by DED. As of January 1, 2010, there is an initial program cap of \$70 million for projects receiving tax credits over \$275,000. Effective as of July 1, 2010, the annual cap became \$140 million for projects receiving tax credits over \$275,000. Owner-occupied residential projects have a per-project cap of \$250,000 in tax credits. Any project, other than these owner-

occupied residential projects, receiving less than \$275,000 in tax credits are completely exempt from the program caps.

House Bill 191 also established a more detailed, multi-step application and approval process. The process now requires that applicants submit preliminary applications to DED detailing the project, which may be completed in multiple phases, and expected costs. Such preliminary applications are prioritized by DED according to the date of submission. Upon review of the application by SHPO, DED then reviews each application to determine whether all required information is included. If the application is complete, DED will approve the application and notify the applicant in writing of the approval for a specific amount of tax credits. DED provides preliminary approvals according to the priority of applications and only to extent that tax credits are still available for authorization under the annual cap. In the event that all tax credits available under the annual cap are approved by DED in a given year, pending applicants are notified and those applications are kept on file to be considered for approval of tax credits when credits are next made available (either in the next year or sooner if prior approvals are rescinded and those approved credits are again made available for approval). It is worth noting that this preliminary approval is merely a notice that the project is preliminarily *authorized* to receive tax credits. This is different from the tax credits being *issued* upon final approval, and later *redeemed* with the state. These preliminary approvals of tax credits are the basis for calculating the annual cap for the Program.

Upon preliminary approval of an application for tax credits, applicants must commence rehabilitation not more than two (2) years from the date of approval. When the rehabilitation project is completed and expenses have been paid, a final application is submitted to DED along with expense documentation known as a “cost certification.” After the final application is received by DED, SHPO performs a final review of the technical project work and DED performs an audit of the cost certification. DED also charges a fee of 2.5% of the amount of tax credits issued. Upon final approval of the project work and expenses, and once the issuance fee is paid to DED, a tax credit certificate for 25% of qualified rehabilitation expenditures is issued and mailed to the applicant by DED in the final year that QREs were incurred or within the twelve (12) month period immediately following conclusion of the project. Currently, applicants may not receive tax credits for rehabilitation expenses incurred prior to receipt of the preliminary project application by DED.

Recommendations

The Commission recommends beginning on July 1, 2011, the Historic Tax Credit program’s annual cap be reduced from \$140 million to \$75 million per year, with no adjustment to the amount of the cap based on increases or decreases in state revenue. The recommended cap should cover all activity under the program and should be permanent.

The Commission recommends that transition rules be adopted for implementing the recommended cap reduction so as to recognize the Governor’s admonition that the Commission’s recommendations should “do no harm” to projects currently underway. Considering the difficult economic climate such rules should ensure that certain existing projects proceed under the current cap rather than the new cap. In particular, certain distressed projects

and projects where significant funds have been expended should be “grandfathered” under the new annual cap. The transition rules require an “Expenditure Test”, wherein applicants must evidence that they have incurred eligible rehabilitation costs and expenses in the particular project which exceed the lesser of (i) fifteen percent (15%) of the total estimated development costs for the project, or (ii) Three million dollars (\$3 million). The expenditure test presumes that qualifying rehabilitation expenses incurred before state approval may be counted, a potential administrative change to the program that the Department of Economic Development has agreed to meet with representatives of the historic preservation community to discuss.

Applicants successfully meeting the Expenditure Test (and all other eligibility criteria) would remain subject to the \$140 million cap, only if the project also meets any of the following criteria:

1. The project contemplates rehabilitation of property owned by a developer as of December 31, 2010, where such developer has also met the above-described Expenditure Test prior to that date; or
2. The project contemplates rehabilitation of property foreclosed upon by financial institutions (or foreclosure equivalent such as deed in lieu) where the financial institution owned such property before December 31, of 2010, and the developer foreclosed upon had, prior to the date of foreclosure, met the Expenditure Test; or
3. The project contemplates the rehabilitation of property foreclosed upon by financial institutions, where the financial institution transferred such property to a political subdivision (or any agency thereof) prior to December 31, 2010, and the developer foreclosed upon had, prior to the date of foreclosure, met the Expenditure Test.

Any taxpayer applying for tax credits after July 1, 2011 would be subject to the new \$75 million annual cap.

The Commission recommends that the cap on Historic Tax Credits for non-income producing single family owner occupied projects be reduced to \$50,000, and further that when the purchase price of the subject property is in excess of \$150,000 no credits will be available.

The Commission recommends that the General Assembly prohibit the stacking of Historic Tax Credits with Neighborhood Preservation Tax Credits.

The Commission recommends that the General Assembly prohibit the use of the State Low Income Housing Tax Credit and the State Historic Preservation Tax Credit in the same project (anti-stacking), except on housing projects using the tax exempt bond only (without the State Low Income Housing 4% Tax Credit program) and further recommends that the amount of State Historic Tax Credits used on such projects not be included in calculating the new \$75 million annual cap recommended on the State Historic Tax Credit program. As described in greater detail elsewhere in this report, the Commission has made a corresponding recommendation with respect to the Low Income Housing Tax Credit.

The Commission recommends that no tax credits be issued on any qualified rehabilitation expenses that have been incurred but not paid.

The Commission recommends that developer fees be proven to be paid during the construction period or prior to the submission of the cost certification in order for a developer fee to be considered a qualified rehabilitation expense.

The Commission acknowledges the administrative efficiencies discussed and recognizes that the Department of Economic Development intends to consider and meet with any and all interested parties regarding the suggested efficiencies.

LOW INCOME HOUSING TAX CREDITS

The Low Income Housing tax credits reviewed by the Commission include the following programs:

- State Low Income Housing Tax Credit (both 9% credit and 4% credit)
- Affordable Housing Assistance Program

State Low Income Housing Tax Credit Program (LIHTC):

The purpose of the Low Income Housing Tax Credit Program is to provide an incentive for the construction of new housing or the rehabilitation of existing rental housing so that it is affordable to low and moderate income families in Missouri. The program is authorized by Sections 135.350 to 135.363, RSMo. Projects that receive credits must create rental units for households having incomes below 60% of the area median family income and maintain affordability for up to 30 years.

This program works by leveraging equity investments from the private sector to provide housing with lower rents. The program provides a matching state credit to the companion federal low-income housing tax credit. The credit is a 10 year credit with a 10 year recapture period. The state credits are equal to approximately 9% of the eligible development costs. Developments financed with tax exempt bonds are eligible to apply for state tax credit for approximately 4% of the eligible development costs. The credit can be carried back 3 years or carried forward 5 years and can be transferred or sold within an ownership structure.

State credits can be allocated up to a 100% match of the federal tax credit allocated to a project. The federal credit is capped at an annual amount set by the IRS and is based on the population of the state and is adjusted annually. The Missouri allocation is currently approximately \$132M per year. Because the state credit is a matching credit it is set at the same amount. The state also has a 4% credit that is issued in conjunction with tax exempt bonds. There is an annual cap of \$6 million on the 4% credit or \$60 million over a period of 10 years. Total state low income tax credits that could be allocated are approximately \$192.0M.

There is no geographic restriction on the eligibility of the credit although credits are allocated by population to three geographic regions of the state (St. Louis, Kansas City, and Outstate). The state credit can be applied to (1) income taxes, (2) corporation franchise taxes, (3) certain bank taxes, (4) insurance premium taxes, (5) other financial institutions taxes, and (6) the express company tax. Any person can submit an application for housing tax credits. The Agency recommends what it feels are the best projects and the Missouri Housing Development Commission actually votes to make the awards.

The economic benefits derived from the program are due to the combination of the equity produced by federal tax credits and the state tax credits and other sources of federal funding. For every dollar generated by state tax credits, the state has historically received approximately two dollars or more of benefit from federal investors who have invested in the projects to obtain the federal tax credit and the passive losses generated from those projects. The federal investors are

frequently large banks such as J.P. Morgan Chase, Wells Fargo, Bank of America and Citibank. Additionally large national corporations such as Verizon, American Express and national insurance companies frequently invest in Missouri projects so that Missouri has the benefit of receiving a substantial investment in its state from companies who might not normally invest in Missouri. Thus, the program is able to leverage substantial investment from outside the State of Missouri to build its housing.

The social aspects of the program cannot be overlooked. A 2007 MHDC study noted the following social costs of not providing affordable housing.

- Greater risk of health problems related to poor housing conditions and inadequate health care. Higher risk of exposure to environmental contaminants.
- Seniors are forced to enter nursing homes or assisted living facilities earlier in life at an increased cost to state programs.
- Increased rates of emotional stress.
- Higher cost burden of housing causes less money to be available for food, clothing, and other necessities. This leads to poor nutrition and a myriad of health problems.
- Poorer health outcomes and increased use of public health services.
- Increased housing instability and great risk of homelessness.
- Poor school performance for children and higher dropout rates.
- Increased likelihood of state intervention to remove children from squalid conditions and increase in justice processing.
- Greater exposure to violence.³

In addition to the social considerations that directly affect tenants there are other social impacts on communities in general when infill housing is built that removes vacant lots or vacant buildings from an area that was previously affected by crime. The infill housing or rehabilitation of a vacant building can turn a blighted area into a desirable area for the community thereby reducing crime and the cost of patrolling such areas and responding to crime in the area. In addition these developments create additional economic development once the area is restored and is no longer blighted.

The program was designed to provide additional equity to affordable housing projects in order to permit rents to be at a level where they are truly affordable for those whose income is less than

³ Cost/Benefit Analysis of the Missouri Low-Income Housing Tax Credit Program, dated June 6, 2007.

60% of the area median income and to provide relief for families who are spending more than 30% of their income on housing.

There are two primary inefficiencies with the housing program. Those inefficiencies are the fact that the housing credit is earned over a period of ten years and the fact that when the credit is used to reduce an investor's state tax liability it results in a loss of the taxpayer's state deduction from its federal tax return.

The investor who uses the tax credit *reduces* his state income tax liability. As noted, the *payment* of a state tax typically results in a reduction of the taxpayer's federal tax liability. Because the state tax credit *reduces* the state tax *paid* (it is not treated as the payment of a tax), the federal deduction is lost. The result is that the use of a dollar of tax credit will increase the taxpayer's federal tax liability by \$.035 thereby decreasing the value of the credit to the state taxpayer by 35%. Recommendations by the Commission for tax law changes that appear elsewhere in this report will address this inefficiency if adopted.

Recommendations

The Commission recommends to reduce the number of credits issued by reducing the term of the tax credit to five years, from the current 10-year term, immediately, and further recommends that the General Assembly analyze a future reduction of the term to 3-years and ultimately to 1-year within an efficient period of time that is respectful of the state budget. By adopting this recommendation the tax credit will become more efficient and will require less tax credits to produce the same equity for projects. If the credit is restructured, syndicators holding outstanding inventories of credits should be given the option of redeeming their credits and receiving new credits with the same characteristics of the new credits. The intent is to place the existing inventories of credits on the same economic footing so that they are equal in value to the new credits.

The Commission recommends that a cap be imposed for the State Low Income Housing 9% Tax Credit program equal to \$16 million per year over a 5-year term and that the State Low Income 4% Tax Credit program used in conjunction with tax exempt bonds be eliminated. In order to achieve the same equity levels in each project and the number of projects financed annually, this reduction must be coupled with the changes to the state tax law recommended in the Tax Law section of this report. Those changes provide that the credit be a certificated, transferable credit which, by virtue of tax treatment, will mitigate the inefficiencies experienced currently in the tax credit value.

The Commission further recommends that the use of the State Low Income Housing Tax Credit and the State Historic Preservation Tax Credit be prohibited from use in the same project (anti-stacking). However, the Commission also recommends that the State Historic tax credit be allowed on housing projects using the tax exempt bond only (without the State Low Income Housing 4% Tax Credit program) and further recommends that the amount of State Historic Tax Credits used on such projects not be included in calculating the annual cap on the State Historic Tax Credit program. As described in greater detail elsewhere in this report, the

Commission has made a corresponding recommendation with respect to the State Historic Preservation Tax Credit.

The Commission recommends a change in the current state law to provide the full project to earn tax credits from the point the first unit of low income housing is leased. This will serve to increase credit pricing. To the extent credit pricing can be increased, the number of credits issued by the state can be correspondingly reduced.

The Commission encourages the Missouri Housing Development Commission (MHDC) to exercise additional due diligence in the evaluation of low income housing projects including maximizing developer participation, minimizing state subsidy, and assuring per unit cost reasonableness.

The estimated impact of the recommendations outlined above and the recommendations for changes to state tax law outlined elsewhere in this report is as follows:

- The combined maximum \$192M in statutory authorizations (\$13.2M annual LIHTC State 9% credits x 10-year term = \$132M, plus \$6M annual LIHTC State 4% credits x 10-year term = \$60M. $\$132M + \$60M = \$192M$) would be reduced to \$80M in statutory authorizations (\$16M annual LIHTC State 9% credits x 5 year term = \$80M, plus \$0 annual LIHTC State 4% credits = \$0. $\$80M + 0 = \$80M$)
- The average annual authorization of tax credits is currently \$165M.
- The savings from the recommendations compared to the maximum statutory authorizations of the state would be approximately $\$192M - \$80M = \$112M$
- The savings from the recommendations compared to the average annual authorizations of the state would be approximately $\$165M - \$80M = \$85M$
- Accordingly, the range of maximum potential savings would be between \$85M and \$112M.
- The number of housing projects combining tax exempt bonds with Historic Tax Credits in 2008, 2009, and 2010, is 4, 2, and 1, respectively.
- The same 3 year average amount of Historic Tax Credits for projects using tax exempt bonds equals \$9.1M. In the proposal, that same amount may be used as an estimate for credits that would not be subject to the new recommended Historic Tax Credit cap.

Affordable Housing Assistance Program (AHAP):

The purpose of the AHAP credit is to provide an incentive for businesses and individuals to make donations to non-profit organizations that assist in the production of affordable rental housing or homeownership for low-income families in Missouri. The AHAP credit is authorized by Sections 32.105 to 32.125, RSMo.

The AHAP tax credit is a one-time credit that may be allocated to an eligible donor for up to 55 percent of the total value of an eligible donation. There are two types of AHAP tax credits: (1) Production credits for donations related to construction, rehabilitation, and rental assistance activities; and (2) Operating Assistance credits for donations that help fund the operating costs of the non-profit organization. The program offers \$10 million in Production credits and \$1 million

in Operating Assistance credits annually. In Fiscal Year 2009, \$7,464,376 in tax credits was authorized, \$10,455,349 was issued, and \$9,917,951 was redeemed.

The Commission recommends changing the distribution of the \$11 million annual program cap between the eligible categories by reducing Production Assistance from \$10 million to \$8.5 million annually and increasing Operating Assistance from \$1 million to \$2.5 million annually.

The Commission recommends eliminating the restrictive language of eligible donors and expanding the definition of taxpayer accordingly to allow individuals and any others to donate and qualify for the tax credit.

The Commission recommends the reduction of the percentage of the AHAP credit from the current 55% to 40%, which is consistent with the Commission's recommendations for reductions in the value of other Social and Contribution Tax Credits

The Commission believes that the above recommendations will result in improved program efficiency. While non-profits are allowed more operating expenses to continue their work providing affordable housing and necessary supportive services to the low income in the state, the recommendation of allowing more taxpayers to participate will widen the donor pool, effectively making fundraising more efficient and timely. The reduction in the value of the credit should not diminish or harm the value of the donation to the donor when the federal tax consequence of the donation is considered.

PROPERTY TAX CREDIT

The Property Tax Credit, also known as the Senior Citizens "Circuit Breaker" Tax Credit, is governed by Sections 135.010 through 135.030 of the Revised Statutes of Missouri (the "Credit"). The Credit may be claimed by senior citizens, disabled Veterans, persons who are 100% disabled, and certain widows and widowers. A "claimant" of the Credit must meet specified criteria in order to claim the Credit. However, the Credit may be claimed only if the eligible claimant either owns or rents a residential dwelling. The Credit first became effective for calendar year 1973 and was last modified by Senate Bill No. 711 in 2008. The eligibility of tenants ("Renters") to claim the Credit has existed since the date the statute first was enacted.

The Credit gradually phases out as a claimant's income increases such that once a claimant's income (as adjusted) exceeds \$30,000 for individual property owners and \$27,500 for Renters, no credit can be claimed. If the claimant's income is less than \$14,300, then the full Credit is awarded, assuming property tax liability meets or exceeds the credit amount. The Credit phases out as income rises from this minimum base of \$14,300 to the "maximum upper limit" specified in the statute.

Renters have been beneficiaries under this statute since the date of its inception. In 1972, Missouri voters approved a Constitutional amendment (Article X, Section 6(a) to the Missouri Constitution) which allowed the General Assembly to "provide for certain tax credits or rebates" for payments of real property taxes in the form of "comparable financial relief . . . [to those benefits afforded homeowners] to persons . . . who occupy rental property as their homes." In 1973, the General Assembly created the Senior Citizen Property Tax Credit Program. Under this original program, owners of homesteads and Renters making less than \$7,500 could claim a credit of up to \$400 to offset property taxes accrued or rent constituting property taxes accrued. "Rent" was defined as being 18% of the gross rent paid by the claimant.

In 1982, voters amended the Constitution to strike the age qualification of 65 from this Section. The General Assembly subsequently expanded the Credit to persons who were disabled veterans, 100% disabled individuals, and claimants 60 years or older who receive surviving spouse social security benefits, and later increased the minimum base and maximum upper limit of income under the program. In 2008, the general assembly expanded the benefits of the program for owners of homesteads by raising the income exemption from \$2,000 to \$4,000 and increasing the maximum award to \$1,100 to homeowners, but leaving the then maximum award at \$750 for Renters. The 2008 amendments to the statute did not benefit Renters, but did not reduce those benefits either.

Renters entitled to claim the Credit are only those persons who pay "arms length" rental to landlords during the year. The Credit is not available if the landlord does not pay real estate property taxes.⁴ The Credit for Renters is (at least initially) equal to 20% of the gross rents paid by the Renter to the landlord. These criteria prompted the following comments and concerns from the Commission:

⁴ Missouri Department of Revenue "Frequently Ask Questions;" 2009 Form MO-PTC, Line 10; 2009 Missouri Property Tax Credit Claim Instructions MO 860-1782 (10-2009), page 2.

1. There does not appear to be any rational relationship between the 20% of gross rent paid and the actual property taxes attributable to that tenant's rent. Among the Subcommittee members, it was the common belief that much less than 20% (and probably less than 10%) of a tenant's rent would be attributable to that Tenant's share of real estate taxes due with respect to the property rented.
2. Many nursing homes, assisted living facilities, and apartments for older adults are owned by non-profit corporations or associations. None of these tenants would be eligible to claim the Credit even though their incomes would be similar to those allowed to claim the Credit.
3. Rent in a particular market is determined by many factors (supply and demand, competition, land costs, utility costs, costs of providing additional services, municipal services, etc., etc.). The Subcommittee does not believe that property taxes have any significant effect on rents; rather landlords tend to charge as much as the market will allow them to charge and still maintain relatively full occupancy.
4. Real estate taxes on apartments vary widely throughout the state, and each area's property tax rates vary as well. The Credit is a "one size fits all" Credit which does not differentiate based on true economic circumstances of Renters in a particular vicinity.
5. Many of the facilities which provide housing to Renters who qualify for the Credit are facilities which enjoyed the low-income housing tax credit (state and federal) and perhaps the historic rehabilitation tax credit (state and federal). Other credit programs also may have been applicable to the facility. These tax credits were designed to reduce the cost of the low-income housing facility for elderly or disabled tenants, and thus, in a very real sense, the tenants in those facilities are already receiving the benefit of the state's contribution towards their housing costs. The Commission did not believe that it was appropriate for tenants in facilities whose rent is already subsidized (through other tax credit programs) to be able to benefit under this Credit as well.
6. In short, the Renters able to claim the Credit do not represent a fair distribution of persons throughout the state similarly situated; instead they are persons who have been arbitrarily selected by the language of the statute for the Credit's benefit, even though others virtually identically and similarly situated lease their dwellings from non-profit (property tax exempt) landlords.

Recommendation

The Commission recommends that the portion of the Credit which benefits Renters be eliminated. Based on the average authorizations of credits for Renters over the period of 2007, 2008, and 2009, the Commission estimates an annual savings of approximately \$57,282,738 if this recommendation were implemented. The Commission does not believe that the portion of the Credit which grants benefits to homeowners who are senior citizens, disabled, or who otherwise are eligible for benefit under the Credit should be modified. Instead, the credits for

property owners should be preserved as presently structured. The Commission believes that the portions of the Credit which define the benefit available to senior citizens, disabled veterans, 100% disabled persons, and widows/widowers, and who are owners of residential dwellings are well written, well administered, and do not require modification.

SOCIAL AND CONTRIBUTION TAX CREDITS

The Social and Contribution Tax Credits reviewed by the Commission include the following programs:

- **Disabled Access – Small Business**, Section 135.490, RSMo.
- **Domestic Violence Shelter**, Section 35.550, RSMo.
- **Family Development Account**, Sections 208.750 - 208.775, RSMo.
- **Food Pantry Tax Credit**, Section 135.647, RSMo.
- **Health Care Access Fund**, Sections 135.575 and 191.1056, RSMo.
- **Maternity Homes**, Section 35.600, RSMo.
- **Neighborhood Assistance Program**, Section 32.100 - 32.125, RSMo.
- **Peace Officer Surviving Spouse Tax Credit**, Section 135.090, RSMo.
- **Pregnancy Resource Center**, Section 135.630, RSMo.
- **Residential Dwelling Access**, Section 135.562, RSMo.
- **Residential Treatment Agency**, Section 135.1150, RSMo.
- **Shared Care**, Sections 660.053, 660.054, and 660.055, RSMo.
- **Special Needs Adoption / Children in Crisis**, Sections 135.325-135.327, RSMo.
- **Youth Opportunities**, Sections 135.460 and 620.110-620.1103, RSMo.

Although each of the above programs are unique, the common thread is they serve vulnerable or at risk Missourians. In most cases these services are provided through not-for-profit community based (or statewide) organizations. Tax credits are used to incent private donations to these organizations. In most cases these private donations provide at least \$2 of donations for each \$1 of credit. The effect of this “credit leverage” is to relieve or supplement state support. The Commission believes that the organizations provide important and necessary services to Missourians and that the use of credits to incent private donations is appropriate and effective. However, we believe there are changes which can improve the credit program while reducing state costs and/or expanding services.

Credit Value

Currently, contribution credits are valued at either 70% (rural), 50% (non-rural) or 30% (certain YOP credits). Although it is not possible to calculate the value of credits to each donor, a person in the highest tax bracket or a profitable Missouri corporation would have an after tax cost for a tax credit eligible contribution of approximately 15-cents/\$ for a 70% credit and approximately 30-cents/\$ for a 50% credit. We believe that private contributions can be encouraged with lower credit values; as an example, rural credits 50% and non-rural credits 35%. This could lower the per project cost to the state and still provide significant inducement to the private donor. This creates an increased efficiency for the tool by accomplishing the same projects with more private investment and less public subsidy.

Accordingly, the Commission recommends that the credit values for the Social and Contribution Tax Credits listed above should be reduced as follows:

- 70% credits reduced to 50%
- 50% credits reduced to 35%

Increased Donor Pool

The Commission recommends the following measures to increase the donor pool for non-profit organizations utilizing Social and Contribution Tax Credits:

- **Conform and Broaden Definition of Taxpayer**

There are significant differences in the definition of “taxpayer” among various tax credit programs. To offset the possible loss of private matching donations that might occur as a result of lowering credit values, we recommend broadening and conforming all definitions to allow for additional donors to participate.

- **Transferability**

Allow all tax credits to be transferable, thus increasing the donor pool and helping offset any loss due to the reduction in credit value. Transferability will allow contributions from non-profit foundations and from out-of-state contributors, along with providing incentives to Missourians who do not have a state tax liability.

- **Individual Limits**

Allow an elimination or increase in “per contribution” limits to offset any loss due to the reduction in credit value thus allowing larger gifts.

Transfer Charge

The Commission recommends that the value of a transferred credit should be reduced to save state funds. This should not materially reduce contributions from tax exempt donors or Missourians without a tax liability. As an example, a transferable credit could be redeemable at 90% of its value; i.e., a 50% credit is worth 45%.

Sunsets on All Social and Contribution Programs

Social contribution tax credits were enacted with the best of intentions. In most cases, such programs are highly effective and beneficial to the State. However, some programs have not provided a meaningful impact despite the best of intentions. Recognizing that needs change over time and removing even ineffective legislation is difficult, the Commission recommends that a sunset of six years should be imposed for each of the above programs that currently lack a sunset (currently only about half of the above programs have sunset provisions). The sunset should operate consistent with the existing Missouri Sunset Act, and legislative history through the Division of Oversight should be included in the sunset report when it is provided to the legislature.

Impact

The Commission believes that the Social and Contribution Tax Credit programs should be

retained. However, we question the impact of several programs, specifically:

- The Family Development Account Tax Credit Program
Originally allocated \$4.0 million annually, the cap was recently lowered to \$300,000. This year approximately ten organizations will use \$25,000.
- Healthcare Access Fund
Administrative confusion and program design has caused this credit not to be used. No credits have been issued since the program's inception in 2007.
- Small Programs
There are several programs which are worthy, but have limited impact – Commercial and Residential Disabled Access and Public Safety Surviving Spouse.

The Commission recommends that the above programs be allowed to sunset.

Oversight

By statute, some programs are subject to significant monitoring, while others are not. The Commission recommends that the authorizing statutes should provide each department with effective oversight authority and oversight tools for use in the administration of credits.

Special Needs Adoption and Children in Crisis

Credits are available for adoption of Missouri and international children. We question using credits for international adoptions. The use of credits for international adoptions reduces funding for Children in Crisis. Accordingly, the Commission recommends that international adoptions no longer be eligible for tax credits.

Food Pantry Tax Credit

The Commission recommends that the current per-donor limit be increased to \$10,000 for food donations and \$50,000 for cash donations to incentivize larger donations to receive the credit.

TAX LAW CHANGES

Tax credits, depending upon their attributes (e.g. contribution, certification, and, transferability) create different tax treatment at the state and federal level and different tax consequences for tax credit users (tax credit recipients, including both buyers and sellers). Occasionally, the tax treatments and tax consequences create a negative impact on the value of the credit because of the tax burden that automatically accompanies the credit. That tax burden typically causes a discount price to be applied to the credit at the time of purchase, which impairs the proceeds derived from the credit when applied to any specific project.

Since the state redeems the credit at the full face value, any discounting during the life of the credit creates inefficiencies in the tax credit as a tool. The Commission analyzed and evaluated the federal and state tax consequences related to the use of state tax credits and has developed a number of recommendations for changes to federal and state law designed to lessen the negative tax consequences and thereby allow the state to issue less tax credits. If adopted, the tax law changes recommended below could result in a savings of as much as \$120 million for the State, without affecting any user, program or project.

Federal Tax Changes

The eight states that border Missouri (Illinois, Kentucky, Tennessee, Arkansas, Oklahoma, Kansas, Nebraska and Iowa) all have distinct tax credit programs, totaling, for instance, 153 programs just for economic development. These local programs all bear the burden of adding a Federal income tax to fiscal investment and use of tax credits.

The Tax Law Committee of the Missouri Tax Credit Review Commission should recommend that the Federal Government eliminate this Federal income tax “cost” as part of a better national policy that allows each State to dedicate scarce resources in these difficult economic times to promote its own economy as local needs dictate, and to shift part of the budgetary responsibility to stimulate the economy from the Federal Government to the States.

Stated simply, state tax credits now carry up to a 35% Federal tax cost, depending on the format of the state credits and the tax bracket of the donor or investor. In these economic times, that cost can no longer be borne as an embedded cost. So, in order to preserve and maximize these valuable and critical resources for local stimulus programs, and given the declining available “stimulus” help from Washington, it is critical to have the States create capital investment incentives and job creation programs at the most efficient cost, specifically without an embedded Federal tax cost.

Accordingly, the Commission makes the following recommendations to eliminate this “tax cost”:

(1) Current Section 164(a) of the Internal Revenue Code provides for a Federal income tax deduction for certain state and local taxes that are “paid or accrued” during the taxable year. However, under current law, a state tax credit is treated for Federal income tax purposes as a reduction in the taxpayer’s state tax liability and not as a payment of that liability. Accordingly, the state tax credit reduces the amount that the taxpayer would otherwise be entitled to deduct

under Section 164. The IRS has privately ruled that purchased state historic tax credits may be allowed as a deduction under Section 164 in Private Letter Ruling 200348002. But, a private letter ruling is not regarded as binding precedent and may only be relied upon by the taxpayer requesting the ruling for the type of transaction involved.

The Commission recommends that Congress amend Section 164(a) of the Internal Revenue Code (Code) to codify IRS Private Letter Ruling 200348002 in order to provide for a Federal tax deduction for the use of all purchased state tax credits.

The Commission recommends that Congress amend Section 164(a) to provide that state taxes are “paid or accrued” for purposes of Section 164(a) to the extent the taxpayer transfers cash, property or state tax credits to satisfy its state tax liability. The Federal effect of such an amendment would be to increase the deduction for state and local taxes paid because a state tax credit would be viewed as a payment, rather than a reduction, of state tax liability. It is noted that this change would affect only taxpayers not in AMT, as State income taxes are not deductible in the AMT calculus.

(2) State tax credits are often certificated and also are transferable. So, a taxpayer may choose to transfer the credit to a third party for cash, rather than using the credit to reduce its own state tax liability. The sale of the state tax credit, under current law results in the realization of Federal taxable gain by the transferor equal to the amount realized upon the sale. The Federal tax on the sale proceeds reduces the effective value of these investment credits.

The Commission recommends adding either (i) a New Section 139D to the Internal Revenue Code to provide that amounts realized from the sale of state tax credits are excluded from gross income or (ii) add a new Section 732(g) to the Internal Revenue Code to provide for a partnership-level election to allocate tax basis to distributed state tax credits, provided that the partnership and the partner, receiving the state tax credits, make corresponding reductions in tax basis of other partnership assets and the partner’s interest in the partnership under Section 733.

If a partnership and partner are permitted to make these tax basis adjustments, then the partner that is distributed the state tax credits will be able to sell the state tax credits without adverse tax consequences, as gain that would otherwise result may be offset by the amount of tax basis allocated to the state tax credits. Section 732 (g) of the Internal Revenue Code will need to provide for a method of allocating tax basis away from other partnership assets to the state tax credits.

(3) The Commission also recommends that Missouri pursue an expedited IRS ruling on the issue of whether State tax credits are capital assets under federal tax law.

State Law Changes

The Commission recommends changing state law to mitigate negative federal tax consequences in the Missouri Historic Preservation Tax Credit program and the Missouri Low Income Housing Tax Credit program, effecting a substantial savings in state tax dollars. The proposed state law

changes are outlined in greater detail in the October 28, 2010 memorandum from Bryan Cave, LLP.

Under present law, a development project that qualifies for the Missouri Historic Tax Credit Program generates a transferable Missouri tax credit to help subsidize the total costs. While neither the receipt of the credit by the project nor the use of the credit by a project partner generates taxable income, the IRS has ruled that when the project sells the credit, it recognizes ordinary income equal to the selling price.

The proposed change to Missouri law would create a supplemental structure to the Missouri Historic Tax Credit. The project would apply for the Missouri Historic Tax Credit in the same manner provided under current law. The project would negotiate with a “new entity/political subdivision” to set up a three-party arrangement where the developer and the Department of Economic Development agree to assign all credits to the “new entity/political subdivision” upon completion of the project rehabilitation. The tax credit recipient then sells the credits for cash, free of all federal income tax consequences to syndicators and other taxpayers. The funds are then granted, in whole or in part, to a corporate general partner, controlled by the Developer, who has elected to be taxed as a Subchapter S corporation, in a transaction that qualifies as a non-taxable non-owner contribution to capital. The corporate general partner makes a capital contribution to the project partnership with the grant proceeds on a tax-free basis. The corporate general partner has no basis in its partnership interest in the project partnership. The approach also requires a change to state law to permit non-profit entities as transferors, sellers, or assigners of Missouri Historic Tax Credits.

Under present law, a project owned by a partnership that qualifies for Missouri Low Income Housing Tax Credits must allocate the credit to a partner in the project partnership. The allocatee, typically a syndicator, usually transfers it to the ultimate end using taxpayer. As a general rule, the transfer of the credit usually results in ordinary income to a syndicator/transferor.

The proposed change to Missouri law would make Missouri Low Income Housing Tax Credits a transferable type tax credit. A similar transaction process as described above for the Missouri Historic Tax Credit program would also be applicable to the Missouri Low Income Housing Tax Credit under this recommendation.

GLOSSARY

Authorization:

The point at which an administering agency determines that a proposed project, or activity is eligible for tax credits under a tax credit program and awards or assigns an amount of credits , pending performance of the eligible project or activity. Not all tax credit programs are designed with a separate authorization phase, particularly tax credits that are redeemed directly on the income tax return (e.g. the Senior Citizens Property Tax Credit a/k/a the “PTC” or “circuit breaker.”) .

Issuance:

The process by which the state provides an authorized tax credit to a recipient who has met the program performance benchmarks. A tax credit is typically issued in the form of a certificate that a taxpayer submits with their tax return. Issuances may occur several times for the same project. Depending on the specific program, issuance of a credit may be limited solely to the applicant or may be issued to investors or contributors in a project. The amount of credits actually issued for a project or activity may be less than the amount initially authorized.

Redemption:

The process by which the holder of a tax credit applies the credit to outstanding tax liability by turning it in to the Department of Revenue or the Department of Insurance.

Carry forward:

A statutory feature of a tax credit defined as a time period that allows the tax payer to hold the credit and apply it against tax liability in future years. (e.g. 3, 5, or 10 years)

Carry back:

A statutory feature of a tax credit defined as a time period in which the tax payer may use the credit against previous year’s returns. (e.g. 3 years)

Sellable/Transferable:

A statutory feature of a tax credit that allows for the credit to be transferred or sold, in whole or in part, to another taxpayer for them to use to reduce their tax liability. Generally, there is no limit on the number of times a credit can be transferred. A handful of tax credit program statutes establish a minimum price for which the credit can be sold. Proceeds from the sale of a tax credit are typically considered taxable income.

Contribution Credit:

A tax credit issued to a contributor for all or a portion of the value of their donation to a non-profit entity for purposes of carrying out an authorized project. The amount of credits authorized for a project is determined by the size, scope and budget of the proposed project. Contribution credits are designed to incentivize private donations. The tax credit value is typically a percentage less than 100%, and therefore a project with a proposed budget of \$100,000 would receive an authorization of \$50,000 in 50% tax credits that can be used to incentivize \$100,000 in private donations for the project. Eligible donations are specified in the statute governing the particular program but typically include cash, stocks, land and other items for which a fair market value may be established.

Investment Credit:

A tax credit authorized for a project to be utilized as equity in the project's financing. The amount of the credits available for a given project is defined as a percentage of total eligible project costs.

Entitlement Credits:

Tax credits that are required by statute to be authorized and issued automatically if a project or activity meets specified eligibility criteria. For entitlement credits, the administering agency typically lacks the discretion to disapprove applications or to recapture credits already issued for subsequent non-compliance with program requirements.

Discretionary Credits:

Tax credits that are may be authorized at the discretion of the administering agency. The specific program will typically define priorities, criteria, and qualifications that must be satisfied for a project or activity to be considered "fundable." Discretionary tax credit programs are often competitive because the aggregate amount of credits applied for in any given year can exceed the aggregate amount of credits that may be authorized under a statutory cap.

Refundable Credits:

Tax credits that are defined by statute to allow a refund to the taxpayer if, at the time of redemption, the taxpayer does not have a tax liability equal to or greater than the amount of the credit. Thus, a refundable credit can result in the direct payment of cash from the State to the taxpayer.

Certificated Credits:

Tax credits for which an administering agency issues a paper tax credit "certificate." The certificate specifies the party to whom the credit is issued, the amount of the credit, and the taxable year of the credit. If the tax credit is sold in whole or in part, the previously-issued credit certificate is reduced or rescinded and a new certificate is issued to the purchaser.

Syndicate:

A group of investors, most frequently investors in a project authorized Low Income Housing Tax Credits, who may redeem the credits based upon each investor's percentage share of investment in the overall project.

Claw back:

A statutory or contractual provision that enables the administering agency to recapture a tax credit already issued or to require the repayment the face value of the credit in the event of failure to perform or otherwise comply with program requirements or other provisions of law. . For tax credits that are transferrable, the claw back provision typically provides a remedy against the initial recipient of the credit and not a subsequent purchaser.

Tax Credits Outstanding:

The amount of the State's present liability for tax credits at any point in time. The amount of tax credits outstanding can be defined in two primary ways –

(1) The amount of tax credits currently authorized, minus the amount of any tax credits forfeited, minus the amount of any tax credits that have expired, minus the amount of any tax credits that have been redeemed,* equals the amount of tax credits currently outstanding; or

(2) The amount of tax credits that have been issued, minus the amount of any tax credits that have expired, minus the amount of any tax credits that have been redeemed,* equals the amount of tax credits currently outstanding.

*The amount of tax credits redeemed includes tax credits that have already expired by the terms of the specific program statute, but that were nonetheless redeemed through the filing of an amended return. See the definition of "Expired Redeemed" below.

Note that the accuracy of any representation of the amount of Tax Credits Outstanding will depend on each administering agency's ability to remove forfeited and expired tax credits from its data and consistency among administering agencies in recording and counting the amount of authorized credits with issuances that "stream" over a period of years. See the definition of "Streaming Credits" below.

Forfeited:

Tax credits that have been authorized but that have been surrendered or returned to the administering agency for projects that would no longer be completed or not completed to the extent authorized.

Streaming Credits:

Tax credits that, by statute, are authorized for a project with annual issuances over a period of years based on achievement of specified benchmarks. Examples include the Low Income Housing Tax Credit, which has streaming issuances over a period of ten years, or the Missouri Quality Jobs Tax Credit, which has streamlining issuances over a period of five years.

Determining the total amount of Tax Credits Outstanding requires a consistent definition of the point at which tax credits are authorized. For streaming credits, the definition could be based on the total amount of the stream (i.e. the amount authorized for all years) or on the amount authorized to be issued in the first year.

Expired Credits:

Tax credits that, by the terms of the specific program statute, can no longer be carried forward to subsequent tax years or carried back to prior tax years due to the passage of time. The specified carry forward period plus one year (to account for the last tax filing year) will provide the date at which a credit has expired.

Expired Redeemed Credits:

Tax credits that have expired under the terms of the program statute but that are nonetheless redeemed due to the taxpayer's submission of an amended return for a prior tax year and applying the otherwise expired credit against the tax liability for that tax year.

Caps

There are a variety of mechanisms by which the amount of tax credits are limited or "capped," including:

- **Program Caps:** The amount of tax credits available under the program, either on an annual basis or a cumulative basis
- **Annual Program Cap:** The amount of tax credits available under the program in any fiscal year or calendar year. The limit can be based on the amount of tax credits that may be authorized or the amount of tax credits that may be issued under the program.
- **Cumulative Program Cap:** The amount of tax credits available under the program over a defined set of years. The cumulative total over a period of years is typically divided up with an annual program cap. The limit can be based on the amount of tax credits that may be authorized or the amount of tax credits that may be issued under the program for the life of the program, barring action by the legislature to reauthorize or increase the cumulative program cap.
- **Per-Project Cap:** The maximum amount of tax credits available to any one project, taxpayer or donor under a particular program.
- **No Cap:** In the absence of a statutory cap, the default for any tax credit program is that there is no cap on the amount of tax credits that may be authorized or issued.

Sunsets:

The statutorily-defined period of time for which a tax credit program is authorized, unless affirmatively reauthorized by the legislature.